TRANSCRIPT OF THE
CONSUMER ADVISORY COUNCIL MEETING
THURSDAY
MARCH 14, 2002

The Council met at the offices of the Board of Governors of the Federal Reserve System, Washington, D.C., at 9:00 a.m.

Members present:
Dorothy Broadman, Chair
Ronald A. Reiter, Vice Chair
Janie Barrera
Kenneth P. Bordelon
Teresa A. Bryce
Manuel Casanova, Jr.
Constance K. Chamberlin
Robert M. Cheadle
Robin Coffey
Lester W. Firstenberger
Thomas P. FitzGibbon, Jr.
Earl Jarolimek
J. Patrick Liddy
Ruhi Maker
Oscar Marquis
Patricia McCoy
Jeremy Nowak
Elizabeth Renuart
Debra S. Reyes
Benson Roberts
Agnes Bundy Scanlan
Russell W. Schrader
Frank Torres, III
Hubert Van Tol

Others present:
Dolores S. Smith, Director, Division of Consumer and Community Affairs
Roger W. Ferguson, Jr., Vice Chairman, Board of Governors
Edward M. Gramlich, member, Board of Governors
Mark W. Olson, member, Board of Governors
Sandra Braunstein
Ann Bistay

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PROCEEDINGS

(9:10 a.m.)

CHAIRPERSON BROADMAN: If everyone would take their seat, we're ready to get started. Good morning. This is the first meeting of this year. I want to welcome everyone to the meeting.

Just one point for those of you who are new, these microphones we're not supposed to have to touch them or move towards them. Just stay in your position and you will be heard and picked up.

I'd like to start by welcoming the new members this years, and they are Janie Barrera from Accion, Texas. Kenneth Bordelon from E. Federal Credit Union. Robin Coffey from Harris Trust and Savings Bank. Thomas Fitzgibbon from MB Financial Bank. Ruhi Maker, Law Office of Rochester. Patricia McCoy, Cleveland State University. Debra Reyes, Neighborhood Lending Partners. Benson Roberts from Local Initiative Support Corporation. Agnes Bundy Scanlan from Fleet Boston Financial. Hubert Van Tol from Fairness in Rural Lending. And we have one new member who isn't with us today, and that is Larry Hawkins from Unity National Bank.

Before we get started with our agenda, I have just one reminder for the Council Members. Today at 11:00 when we break, we have to go as a group over to the atrium of the building across the street, the Eccles Building, for our picture with the Chairman and the Governors.

And because of the security issues, it's important that we all go together as a group, so immediately upon the break, I'd just ask that we all gather at the elevator and the Staff will take us across the street through the tunnel.

With that, we're ready to start our agenda. I'll turn the meeting over to Jeremy Nowak to talk about the Home Mortgage Disclosure Act.

MR. NOWAK: Thank you, Dorothy. We had, as you can imagine, a spirited conversation about the Home Mortgage Disclosure Act, and we focused on three issues in particular as they relate to some Final Rule Amendments published in the Federal Register.

We focused first on the appropriateness of Rate Spread Thresholds. Secondly, we focused on the issue of the required reporting of lien status of first lien or second lien mortgages. And third, on the issue of reporting on race and gender, et cetera, over tougher telephone applications for mortgages, so they're the three issues that we'll concentrate on today in our conversation. And as we go through this, I'll call on different Members to just start the general engagement on these issues.

Prior, I should say, to our conversation about the appropriateness of the proposed Rate Spread Thresholds, we had -- the Committee as a whole, the CAC [Consumer Advisory Council] as a whole was given some background by Fed Staff on what the basis for their proposal is based on their understanding of what loans would be captured, or what loans would not be captured, what percentage of loans in particular, what percentage of sub-prime loans out in the market place might be captured.

In the Final Ruling, the Board proposed reporting a threshold of three percentage points above the yield on comparable Treasuries and Securities for first lien loans, and five percentage points for subordinate lien loans, which generally have a higher APR [annual percentage rate], although there was some conversation somewhat later about whether that's always so.

We disciplined ourselves as much as possible to not go back into the history books and have the conversation on whether they should be collected at all, and what constituted -- where this did or did not constitute political or reputational risk in this collection, or the fact that the data may be misunderstood, and we just stayed on the rate spread thresholds. And so to kick us off, I want to first just stay on that issue. And to kick us off on a conversation about that, let me turn it over to Pat, who's got some thoughts about that, and then I'll turn it over to Earl.

Pat.

MS. McCOY: Yes. Thank you, Jeremy. As Jeremy noted, the Council had already recommended that pricing data for sub-prime loans be reported under HMDA [Home Mortgage Disclosure Act], and so the only question is now how -- what form should that pricing data take, and Jeremy has described the Staff's proposal.

I believe that the Staff's proposal has been very carefully considered and well thought out. The data needs to do two things. First, it needs to cover the sub-prime market. Setting the triggers at three and five percent for first and subordinate lien loans accomplishes that. In particular, for first lien mortgages which presently seem to be the area with the greatest problem, a three percent trigger would cover 98 percent of all sub-prime first liens.

The second goal should be to achieve as much accuracy as possible while minimizing the burden on institutions. Once again, the Staff's proposal accomplishes that.

First of all, the proposal would measure spreads over Treasury Benchmarks, instead of raw APR data. That's important to take into account, influence in the underlying interest rates. Secondly, the spreads have remained relatively stable over time, so we feel fairly comfortable with spread data.

With respect to burden, institutions already use the same Treasury Benchmark to determine HOEPA [Home Ownership and Equity Protection Act] compliance, so they would not have to do any radically new computation in order to know which data to report. Thank you, Jeremy.

MR. NOWAK: Sure.

Earl, you had a perspective on this that related particularly to the issue of when this ought to begin, and what the paper burden was. Could you share that?

MR. JAROLIMEK: Sure. You know, I guess the burden is one that is very, from a system standpoint today in the collection of HMDA data, what we would envision in our company, and I'm sure most banks, if not all, would have the same problem, would be that the systems are far removed from the HMDA data collection as compared to those that would produce the information of APR, and I'll throw in lien status, as well, as another concern, so there is a very real burden here for us to try to overcome.

Compounding that situation and trying to get the systems to somehow integrate or talk to each other, would be the current activities banks are weighing today in terms of the USA Patriot Act, new privacy notices that need to be mailed again this year.

Several banks, due to Y2K delays, are going through many systems changes that have been delayed until this year, not to mention the HMDA changes that are already in place for January 2003. So I -- one of the things that I would like the Board to consider would be to -- given this calculation is somewhat complex, primarily and particularly for a small bank, would be to make the -- make it optional for a bank to report all APRs on their HMDA, removing their burden of having to do the calculation and do the comparison to the Treasury Security as an option. And then the other thing would be to make a strong appeal to delay this until January of 2004, to compensate for the events that I've gone through and the system concerns of trying to make this happen.

MR. NOWAK: And I believe the --

GOVERNOR GRAMLICH: Just a question on that. On the small banks, we've offered software that does -- fills out the reports. And the first question, is that helpful to the small banks? The second question is given the change in the census, doesn't -- don't banks have to do a lot anyway to begin their HMDA reports in 2003? And do you really want to open this up twice?

MR. JAROLIMEK: To your first question, I think the real problem or complexity lies in the retrieval of the information as opposed to the software the Fed has offered to actually complete the reporting part. It's the retrieval part that really causes the problem.

The HMDA Software is typically driven off, if you're lucky enough to have it associated with your application software, and many banks don't even have that luxury. They're doing it quite manually, but some do. The APR and lien status would either be retrieved from a separate system which would produce the documents, calculate the APR, and the lien status in many cases, I think would have to be obtained from the file itself. So the Fed Software would help in the reporting, but that's kind of the final step.

As far as the timing is concerned, I guess the other problem that the Fed could incur is the quality of data. I think the calculation is quite a challenge, and could produce a lot of incorrect data inadvertently. Nevertheless, the use of it would be in question if this were to come so soon.

MR. NOWAK: Yes.

VICE CHAIRPERSON REITER: I have a question. Earl, I believe in the past, if I'm not mistaken, you've expressed some question about the accuracy of the APR, reflecting whether the loan is truly a sub-prime loan or proprietary loan. Do you think that the current suggestion to have a disclosure of the spread as opposed to the APR is more reflective, and would give better data?

MR. JAROLIMEK: No, I -- because we're still using the APR in the calculation of the spread, so I think the problem still exists. You know, out of courtesy to the Committee and the others, we kind of stepped passed the concerns about the flaws of the APR, and quite honestly, the comparison to the Treasury Security, which oftentimes the rates move on different paths, so there are certainly concerns with the industry on the use of that data to begin with, but if we do have to report some pricing data, I think the APR is present in either case, so the problem still exists.

MR. NOWAK: Dorothy.

CHAIRPERSON BROADMAN: Yes. Thank you, Jeremy. Two comments in terms of the value of the pricing information. I just think it's important that people are made aware of some of the problems here. The Board is recommending using the same methodology that used for calculations for HOEPA to make this easier on industry. And there are -- there is a timing issue with that data, and I just think it's important that this be communicated as part of the Board's educational process.

The Benchmark, I believe, relates to Treasury the month before the application was taken, and then that is compared to the final rate so there can be a fair amount of time between those periods of time that could, in a more volatile interest rate environment, distort the comparison number.

The second thing I just wanted to add to Earl's comments, is that I hope that the Board will seriously consider delaying this a year. There's --people focus on the computer issues related to this, but there's a lot more that has to happen before that. Industry needs to go back, change its applications. We need to train anybody who takes an application in this process. We need to train the people who then transfer that into the computer system, and then there's the issues that everyone's talked about at the front end and the back end, systems talking to each other.

The other thing is that any applications taken in 2002 that close in 2003, if there is not a one year delay, would be included in this, so I just really question the feasibility of our ability to do this by 2003.

MR. NOWAK: Yeah, Tom.

MR. FITZGIBBON: I just have one comment, and that is, you know, the reference to HOEPA I think is interesting, because for the most part, that's a guideline for how much sub-prime lenders can charge without having to make a disclosure. It's very rare, even though we test in our bank to make sure that we don't exceed the guidelines, we've never had a HOEPA loan in the seven years I've been there, so it is something that I think is an anathema to most of the industry who don't do loans that exceed HOEPA, so it isn't something that they're generally used to working with. So I think there is going to be an educational component here to make sure that the industry understands how to calculate the spread to ensure that it's done correctly. That's the one thing I would want to point out.

MR. NOWAK: Yes. Teresa.

MS. BRYCE: One other question that has been raised is the question of the term of the Treasuries that you calculate this against, and right now it's comparable. Securities on most loans have 30 year period, and so it would be a comparable Treasury. But in fact, the industry in large part has moved to calculating rates off of a ten year Treasury, and most loans are not outstanding longer than that, so one of the issues that I think needs to be relooked at is whether or not it's really a ten years Treasury or something that is the right calculation.

MR. NOWAK: As opposed to just comparable maturity.

MS. BRYCE: Yes.

MR. JAROLIMEK: And, Teresa, just one more point on that. AS I talked to our Treasury people, they made an observation about the Treasury Securities, saying that the price is typically based on average life; whereas, a state of maturity is more related to a loan, so are these really good comparables to be using? And I don't know -- I'm not an economist but, you know, perhaps that brings into question again the quality of the data and the use of it.

MR. NOWAK: Well, of course, one problem -- I'll get right to you, Hubert. One problem had to do not only with that, but can you measure against -- what's the right benchmark for cost of funds, but of course, this is the slippery slope. You need some benchmark, and I think that based on the earlier presentation of data for CAC, there was some sense that that was -- if you have to pick a benchmark, these were not -- these were fair benchmarks, I thought. Hubert.

MR. VAN TOL: I know we're not supposed to walk the cat backward too far on this, but --

MR. NOWAK: Don't. You don't want to.

MR. VAN TOL: Since Earl raised the issue of voluntary reporting of all APR, I think consumer groups would find that very useful as well, to get more data that covers a bigger range of lending prime, as well as sub-prime, because if we had that complete range of data, I think discrimination occurs in prime lending, as well as sub-prime lending. And if that solution can bring less regulatory burden to the banks, and also bring us more data, I think it would be a useful thing to look at.

MR. NOWAK: Thank you. Yes, Les.

MR. FIRSTENBERGER: One of the things I think we need to note, or it would be very helpful I think, if in the Staff commentaries or somewhere in the reg itself, just a notation on the limitation of the data. The data is a very rough proxy for credit risk, and it shouldn't be used as an indication, as other people might try to use it, for discrimination or things of that nature. And just a comment to that effect, I think would make the industry feel well.

MR. NOWAK: Ruhi, did you have a point about that? I know --

MS. MAKER: Yeah. As you know, I'm an attorney, and also we've been cutting HMDA data going back to the 90s, and I think the point that was made in the Committee yesterday was that, you know, what would -- for example, we right now have loan denial data, and it varies by race. And you can control for income, and it still varies by race, so upper income African Americans are denied at a much higher rate than Whites, and that's been the case for years. And certainly, as somebody who does -- our office does Fair Lending -- Fair Housing litigation.

That alone is not a prima facie case, and of course, there are groups that are not as sophisticated, so supplemental information would be helpful. But, you know, banks feel that they're going to be shaken down on misinformation then they have to stand firm, because I think there are a lot of groups like ours who use the data responsibly, and wouldn't risk our own, frankly, reputation or risk of saying things that are inappropriate, and which wouldn't hold up in a court of law.

MR. NOWAK: So for example, you would understand that in that case without having credit scoring information, that that -- as an example, that might be problematic. Teresa, this is usually when you come in, however, and tell us tales of something from Bank of America, or somebody from long ago. Right?

MS. BRYCE: Well, I think one of the comments that had been made yesterday was that no one has brought any of these cases.

MR. NOWAK: All right.

MS. BRYCE: And I had just piped in by saying that was not true, as several million dollars of defense costs later essentially petered out, and so it really is a major risk. It's not a risk of losing so much at the end of the day, as just in a class action context, just the cost of defense.

MR. FIRSTENBERGER: So just -- again, just to ask for a sentence or two in the commentary just to clarify that would be great.

MR. NOWAK: Right. Thank you. See what you've done, Hubert. Yes.

MS. CHAMBERLIN: I think that a sentence like that is fine up to a point. I think the reality is that it is not always approximate for a credit risk, and that that's one of the issues. And some form of clarification would be useful. As Ruhi said, groups that litigate responsibly, and we are among them, would not bring a lawsuit on that basis. But I think that Teresa's Bank of America exception is really the exception that proves the rule. If we can only point to one lawsuit, however unpleasant and expensive it was for Bank of America then, in fact, there are not a lot of people out there rushing around suing irresponsibly.

MR. FIRSTENBERGER: We can get you a list of cases.

MR. NOWAK: Yeah. With that, this may be a good time to move into the conversation about lien status, if there's no -- if there are any other burning points on this issue.

The second point had to do with the required reporting of lien status. Here, we had a conversation really about three things. One had to do with the paper burden. Some banks have lien status information that's easily available on applications, and it's not a problem. And for other banks it is more of a problem, so there was the paper burden reporting systems issue, and I'll turn to Earl in a second for that.

The second had to do with the question of is lien status, to what extent does -- what does lien status tell us about pricing. And I think there was agreement that in general lower lien status means you're going to have a higher price; although, obviously, this is context specific, and there are instances where that's not so.

And third, there was this question about reporting on lien status for loans and applications, but not for purchase loans, and what are the issues there? And should we -- should it be also for purchased loans, and is that really possible given the way loans are purchased in trenches and pools, what would that tell us, and what makes sense there? So they were really the three parts of the lien status issue that we took up. And, Earl, let me turn to you on the -- not to pigeon hole you into the paper burden guy this morning, but let me turn to you there.

MR. JAROLIMEK: Thank you, Jeremy.

MR. NOWAK: But it was also offering us first lien loans at prime in North Dakota, and second lien loans at prime in North Dakota, so we were all getting ready to move.

MR. JAROLIMEK: Actually, across all of our 12 states, Jeremy. No, I think the burden and the quality of data issue again, and I do seem to be the spokesperson for that, but I think they're very valid concerns. Otherwise, I wouldn't bring them up, but there seems to be a premise that high pricing is associated with lien status, particularly junior liens.

And while that might be true in some cases, I don't think it's always true. And a couple of examples I can think of would be a home equity loan, or a loan for a consumer purpose where a home is taken as an abundance of caution. Creditworthiness of the borrower and relationship with the borrower tend to drive the pricing as opposed to the lien status.

I mean, in many cases, we may not go out to perfect the lien until well after the transaction is consummated because we know we have a good borrower in front of us, and so I guess the validity of the relationship is somewhat in question for many banks that would report. And oftentimes, the pricing for those borrowers is at a very, very good rate, so I just wanted to make that point in terms of the validity.

MR. NOWAK: Are there other comments? Yes, Teresa, on lien status.

MS. BRYCE: I think that whether the data is collected and whether there's a difference in price really depends on the type of lender that you're talking about. A lender that sells into the secondary market is typically going to have to identify whether the loan they're selling is a first lien status or a subordinate lien status, and so would generally have that data.

But someone who is a portfolio lender may not capture that information. Just the same, the pricing may be different for that very reason because the pricing would be different if you're selling the loans to an investor, and they generally would price that differently, so I just wanted to raise that, because that may make a difference in terms of which lenders think it's not as big of an issue, because they already have that data, versus other lenders that may not have that data today.

MR. NOWAK: Additional comments or questions on this issue?

MR. FITZGIBBON: Over here.

MR. NOWAK: Oh, I'm sorry. Yes.

MR. LIDDY: Yeah, that's the point that I think I wanted to make. I was a part of that meeting, but for instance, to the extent that we have it, it's not a big deal, but in a lot of cases it's a product where we'll just make a car loan, an indirect car loan to the dealership, and whether that person comes back in later on and says hey, I want to deduct this. Would you let me put a mortgage on the house to secure this loan?

We say sure, and we don't go look at that. We also don't make any warranties as to the deductibility. In fact, we tell them they have to decide that for themselves. We don't go out and do an appraisal, so we don't know if it's second, third, or whatever. It's just whatever they want to do for their own tax purposes.

To the extent we'd have to go out and secure that would be something we haven't -- we're not geared up to do today, and that's just one kind of product.

MS. BRYCE: But that particular product line wouldn't be picked up by HMDA, I mean, if you are securing it for a car loan purchase.

MR. LIDDY: But I'm just saying there are other loans, HMDA type loans where different products where we might not have that information. I'm saying to the extent we have it, it's not a problem, but if the bank doesn't need it.

MR. NOWAK: Pat.

MS. McCOY: Yes. Just in response to Earl's point on pricing, if you look at industry data, there generally is a fairly strong correlation between lien status and APR surcharge for subordinate liens, and so while there may be some anecdotal data of subordinate liens having the same pricing as first liens, I think that is against the trend. And, in fact, there is a strong correlation.

MR. NOWAK: Those of us believe three anecdotes are a fact pattern. Other questions or comments on this issue? If not, I would move to the third issue that we discussed, which is that we focus in on which had to do with requiring that telephone applications for mortgages that ask for information on race, ethnicity and gender, and here we had a conversation around several things. One had to do with why the reporting of race was going down, and what that indicated, and did we have information on that. And I think it was sort of a common sense. That's not necessarily a good thing. We'd like to have that information.

Second, we asked lots of questions about the way discrimination dynamics work, and where is asking for that information, or when do you ask for that information in terms of a discrimination dynamics. In fact, there was kind of an interesting conversation about do you ask for it in a telephone application.

Would you ask for that in the beginning of the application, or would you -- in some instances, some people would like not to give it to you in the beginning of the application because of fear of discrimination. They'd like to give it to you at the end of the application, at the closing itself. And there is actually some interesting anecdotes about that. Robert Cheadle had one of those, so this whole issue, I think, had lots of different aspects to it.

We are all sort of aware of the escalating reporting problems. And let me turn it over to Tom, and maybe you could talk to us a little bit about it from your perspective.

MR. FITZGIBBON: I think one of the major issues that we talked about yesterday was at what point would you begin to gather this information, and especially as it related to Internet or electronic types of applications, as well as applications over the phone. And there were suggestions in the discussion that you could gather this information at the point of closing. And there was a debate, because in essence, you would be potentially missing the most important part, which is information about the decision itself, and how that could have been impacted by race or gender.

And so, I think the -- although there wasn't consensus, we don't tend to try to do that, but there was general understanding that we needed to capture as much information on the front end as possible, because that was one of the most important and critical points, which we needed to get that information, to begin to look at how those decisions were rendered, and whether they were rendered based upon a prohibited factor. And so, looking at trying to structure methods for the industry to gather that information, either orally through a telephone interview, or as part of the application process on the Internet, that that would be -- that information would be something that would be -- we'd look for as part of that process.

MR. NOWAK: Hubert, I know you had some thoughts about this. Would you like to share them?

MR. VAN TOL: Well, I think, you know, from a consumer group perspective, the data is really getting seriously compromised by the loss of race and gender data on the telephone applications, so if the -- I think we can go on from something like eight percent race and ethnicity not reported, to close to 25 percent over the last eight years, and the same thing with gender.

So at a certain point, we'll reach the level, I think, that not much useful developed from the HMDA data at all, if we're not correcting it somehow, so I think it is a very important issue, and I hope the Board does see fit to impose that.

MR. NOWAK: Robert, you gave us an interesting anecdote about how occasionally this plays out in Indian Country. Do you want to repeat that?

MR. CHEADLE: Yes. I was concerned that if -- as the ethnicity information is collected, I think the question needs to be asked. It should not be assumed just in a face to face interview, or at closing, Mr. Fitzgibbon, that the person is necessarily identifiable. They are not, so I was concerned that, number one, the question be asked. And number two, that it may be better to ask the question after the deal is closed, because prior to closing, the answer given may not be accurate.

MR. NOWAK: And you gave us an example of Oklahoma.

MR. CHEADLE: The example in Oklahoma is that all Oklahoma Indians are not identifiable, and they come in many shapes, sizes, and flavors and colors, and for example, I'm not that identifiable, but I am definitely Native American. We have a lot of other Native Americans that appear to be more African American, and in fact, they are Indian, so the question definitely needs to be asked.

MR. NOWAK: Dorothy.

CHAIRPERSON BROADMAN: Yeah. I think this is a difficult question, because my sense is we all want good data, and we want it accurate. And it is an issue, it is a problem that this category has increased substantially over time.

I don't really know what the answer is. I think on the other side though, is that some people believe that more minorities are using these anonymous ways of applying because of concerns of how their application will be treated, and that if asked on the telephone, that we may not get the accurate information. If that, in fact, would happen, that data gets added into the data that's taken face to face which may be more accurate. We're not sure, and could have a negative affect on the accuracy of -- especially as it pertains to minorities, of that data, so I think it's a difficult issue.

MR. NOWAK: The issue here, and I'll get to you right in a second, Pat. The issue here had to do not only with the requirements for telephone applications, but the conversation became more generic given the way between the Internet and telephone, given the way applications are being taken, the sort of more generic problem of the quality of data. Pat.

MS. McCOY: Yes. I just wanted to add that if we also have concerns that the telephone solicitations are used to target particular groups, then we -- it's especially imperative to try to pick up this data. I understand the concern about accuracy, but to leave that group of applicants completely unsurveyed, I think leaves the danger that we will not understand the problem of targeting.

MR. NOWAK: Ruhi and then Teresa.

MS. MAKER: I would echo that. I mean, we have looked at sub-prime lenders, and some sub-prime lenders you see that 99 percent of the data is race not available. And I would echo Pat's comment there, and I think I would rather have more data -- you know, our data is already inaccurate, because up to a third of it is race not available, so I'd rather have the risk of having people -- and I think most people would respond, either would choose not to respond, or would respond in a way that was accurate. And we would have slightly more accurate data than we do now, because I think now a third of our data is inaccurate. And you can't track race lending over a period of time because so much of it is now race not available.

MR. NOWAK: Teresa, and then Agnes.

MS. BRYCE: There are a number of lenders who already do this. We do, and we have a lot of people who decline to answer. It's something that is easily, I think, done up front, and it has to be scripted, obviously, so that the customer knows that they have the option of answering or not. But I think for the reason that Dorothy raised, a lot of people do decline to answer, even when they are asked for the data.

MR. JAROLIMEK: And I would just observe, we're seeing a very strong increase in the no, I don't wish to answer those questions, in our branches and banks. I would assume that would apply to telephone apps, as well.

MR. NOWAK: This is the U.S. Census conundrum, I think, is what we're in. Agnes.

MS. SCANLAN: I would agree with that. I wasn't part of the discussion yesterday, but certainly we've seen an increase in people not wanting to respond, not wanting to ask. But I do still think that the question has to be asked. You can't make any assumptions, but over the telephone it's obviously difficult, on the Internet it's difficult, but I still think the question has to be asked, and there can't be any assumption made.

MR. NOWAK: Janie Barrera.

MS. BARRERA: I think it's appropriate when one asks this question, and if it was asked at the end of the process in terms at the time whether the loan was approved or not approved, to capture the data at that point. Then it does not go into your decision making factor of, you know, using ethnicity, or race, or whatever in the decision, but it's done at the end.

MR. NOWAK: Yes.

MR. TORRES: Out of curiosity for some of the lenders here, how is the question asked? You know, because I think that, you know, different ways -- to me, different ways the questions get phrased could almost trigger no, I don't want to answer that because the hairs on the back of my neck are being raised that this might be used against me, versus other ways that it might be asked where it's, you know, less problematic for the person.

MR. NOWAK: Tom, and then Teresa.

MR. FITZGIBBON: I know within our institution, we train people to go through the whole discussion with the customer before, you know, what is the purpose of the gathering of this information, is to prevent discrimination. And so, the purpose of this is to gather it to ensure that we're doing the right job, and that we're not discriminating in the lending process. However, I know, you know, having done some testing and called up other institutions that that's not necessarily what gets out there. It's the --

MR. TORRES: How is your response rate to that question?

MR. FITZGIBBON: The response rate to that question is very good, once it's explained to the consumer. Too often, however, you know, if you're dealing with commission loan officers who are anxious to get the application signed, that's the next thing on the 1003, is that they've just got to go over it real quickly, and don't necessarily explain the entire purpose of it to the customer.

MR. TORRES: Because I think it would be problematic if it was in a line of questioning like we -- you know, we need to get the following information from you --

MR. FITZGIBBON: Right.

MR. TORRES: -- to approve your loan. Give us your name, address, income, assets, debts, race, and it's thrown into the mix.

MR. NOWAK: Well, then this is a question for Internet and telephone applications.

MR. FITZGIBBON: It is.

MR. NOWAK: And it is a question for transaction costs in the mortgage markets. Yes.

MS. BRYCE: It's at the end of the 1003. And typically, it's stated the way it is on the 1003, I think, for most lenders --

MR. NOWAK: Right.

MS. BRYCE: -- where it's made clear that this is information that the government requests that we ask for, because the concern that most lenders have in asking for the information is that the customer will think we're asking for it for some nefarious reason, instead of -- so the main point that we try to make is to make sure that they understand that it's the collection responsibility that we have, vis a vis the government. And that's why we're asking for the data, and it's up to them as to whether they want to give it to us.

MR. NOWAK: And in the case of commission brokers that are incentivized in particular ways, are there issues? I'm just wondering about that. Tom or Elizabeth.

MS. RENUART: I just wanted to comment that any time I have gotten a mortgage loan and I'm in the prime market, it's never been explained to me in a way positively like Tommy just described, which wanted me to give the information. I happen to know why the information was being requested and thought it was appropriate to answer the questions, but it was never explained to me in a positive light, and so particularly when there are 50 percent of all mortgage loans are being made through brokers, I think there's some breakdown between the positive way to characterize it that you might do in-house in your institution, and what's actually happening on the street.

MR. NOWAK: Right. There was another hand. I'm sorry.

MR. JAROLIMEK: I was just --

MR. NOWAK: Yes, Earl.

MR. JAROLIMEK: Frank, I have a 1003, so I can show it to you afterwards. But, I mean, what we train our people to do is to actually read this. And I think, you know, in here as Teresa pointed out, language that does, you know, give them some comfort that the data is not being collected to make a credit decision, but is instead being required for government monitoring purposes, so I can share that with you.

MR. NOWAK: Other comments or questions on this particular issue? If not, then I think we were quite efficient with our time. Right?

CHAIRPERSON BROADMAN: Yes, we were very efficient. We're 15 minutes ahead of schedule, so I'll turn this over to Manny to talk about the Community Reinvestment Act, and if you have extra time if you need it.

MR. CASANOVA: Okay, great. Thank you, Dorothy. As most of you all know, there was a 2001 advance notice of proposed rule making that was sent out last year, and the comments have come back, and in our Committee discussion yesterday, Staff briefly went over, summarized the various comments. There were 13 topics as part of the summary, and of course, we didn't have enough time to go over all of them. We kind of skirted around most of them, but the two main topics that we focused on were the investment test. We had a very good, I think, balanced debate on that. And then we also discussed the definition of small banks.

A couple of things that I wanted to touch on that I found, I guess, kind of surprising when you look at the summary of comments, is that there was only 35 comments that were received on the strategic plan, which I thought that was kind of interesting. I thought there would be more comments on that, but there wasn't. Apparently, particularly the community groups believe that the strategic plan option should be eliminated, so I thought that was kind of interesting.

As far as the ratings, there was a section on the ratings, and I think a lot of bankers share this notion that the cost of obtaining an outstanding rating was simply too high for some banks. And I know our particular bank, we feel that way. I think we do a good job in the lending test, the service test, but the investment test portion of it, obviously requires some outlay of money. And, you know, to achieve an outstanding, is it really worth it, so we have some discussion about that.

Going back to the investment test, again where we spent most of our time, the majority of the commentors asserted that there wasn't enough investment opportunities in their assessment areas, forcing them to make uneconomic investments, or outright grants, rather than investments for which they had any hopes of return. This complaint was heard often from smaller large banks, especially in rural areas, and Earl will talk about that a little bit.

Community groups, on the other hand, disagreed with the assertion that there are not sufficient opportunities, and we'll hear from some of the groups on that. Generally, community groups did not believe that the Agency should reduce the weight given to investments, or eliminate the test. And on the other side, industry commentors wanted to reduce the weight given to investments, or make them entirely optional. So to kind of kick that off, Earl, why don't we go with you, and why don't you share your comments.

MR. JAROLIMEK: Sure. I would like to propose that the investment test be made optional, and at a minimum, have the waiting be de-emphasized compared to its current state. And I think we're a pretty good example of what the investment test maybe didn't intend to do, but the results for our corporation have been somewhat troubling.

We're a large bank by CRA [Community Reinvestment Act] Standards. We're six billion; however, our branch banks, 133 of them, are located in small rural communities in 12 states. To meet the investment test standards, what we've been forced to do, given the lack of opportunities in many of these communities, and there are opportunities in some and we've taken advantage of them, but not to the level at which the expectation of investment in order to pass that test would be made. So having exhausted those efforts, have gone to look at mortgage backed securities as an investment alternative that would qualify.

I think the troubling part of that is that many of those pools are available in large metro areas that are within our geographic region. For example, Milwaukee, Minneapolis, Phoenix, where we don't have a branch within 100 or 200 miles. And I don't know that that meets the intent of meeting the credit needs of one's community, so it has resulted in some things that have changed our business strategy, perhaps unintentionally, and really shifted capital outside of our local communities, which I don't think was intended, as well.

So I guess we would make an appeal that for those banks that do a great job in investing and do it very well, let them continue. And we would see if it was made optional, they would certainly have the ability to do that. But I don't know that one size fits all, and for small banks that are just barely over the threshold, or that have difficulty finding opportunities, they might find some other options that are still community development, but just not specific to the investment test.

GOVERNOR GRAMLICH: I wonder if I could ask about that. So your full suggestion would be -- I mean, the investment test might not go away, so your suggestion would be that at the institution's options, you could do something like fold the investment test into the lending test? So you'd have an enhanced lending test, would that be the --

MR. JAROLIMEK: That would be one of the options. The other one we talked about yesterday was a community development type test or structure where the investments would be captured in there, as well as other lending or service community development activities. Personally, I'm not sure which is the best alternative in the end. The investment test today carries a bit too much weight, and if the result was that it was de-emphasized and credit was given, its primary role as I think was the intent of the statute, that would be preferable.

MR. CASANOVA: Uh-huh. Earl, you also had an opinion about the weight. And assuming that the investment test is in place, it doesn't go away, do you have any comments about the weighting?

MR. JAROLIMEK: Yeah, I guess my last comment would speak to the weighting. To not de-emphasize credit and change the behavior of banks who might see many community development lending opportunities or small business lending opportunities, but instead shift capital to the investment test just to make that grade.

MR. CASANOVA: Because the way the grading is right now, the investment test, I guess, receives 25 percent of the overall weight. Hubert, did you have a comment?

MR. VAN TOL: Earl, I think some of the problem could be dealt with as well, just by looking at how the census track issue is addressed in rural areas, and I think we need to put that on the table, as well, because in many rural areas you just have -- you have very few census tracks, or there's not -- there's very little income variation between the census track, so I understand that difficulty. But there definitely are community development needs in those rural communities, so there may need to be some way of looking at, you know, how to address that without tying that to geographies.

MR. CASANOVA: Dorothy.

CHAIRPERSON BROADMAN: Yeah. Yesterday after talking about this, I would say it was a fairly passionate discussion for a very long period of time, we asked the question to the Board Staff, how did this ever come about? What is the history here? And I think it's pretty interesting. And the way it was described to us was that when this regulation was being reviewed earlier, that some of the larger banks raised their hands and said well, we're doing -- we're providing grants, and we are making investments, and they are for community development purposes. Shouldn't we be getting some credit for this? And so from that, we ended up with this somewhat different picture than I think the recommenders had originally intended, which is a lesson to all of us, be careful what you suggest.

I think we need to get back to that. I think that really is the right spirit, and what's happened out of this is that we've developed a fairly large industry around this investment test, where third parties are repackaging activities that are already going on, making a profit, and there really isn't any additional community benefit. We've also seen yields for some investments get too low, so that CRA motivated institutions are making those uneconomical investments, and non-regulated institutions are exiting those markets. Those are the unhealthy responses.

We've also made non-profits and some funds development, excuse me, dependent on these contributions, and on cheap money. And I think that needs to be taken into consideration if a change is made.

I do think we need to keep an incentive for making investments, but I do think we need to relieve the pressure, and so I would support Earl's comment, that it be a voluntary activity that banks be encouraged to do it when it makes sense in their markets, and given the infrastructure of their organizations. When we get credit for something within the CRA context, we do look at it and try and find ways to get that credit, so I don't think it will fall off entirely. I think we'll just see some of the activities that probably shouldn't be undertaken will go away.

MR. CASANOVA: Thank you, Dorothy. Debra.

MS. REYES: Speaking from the community side on this issue, we see many of our financial partners are being very, very good corporate citizens who do the right thing and they invest in their communities. However, a lot of that is driven by the motivation of the Community Reinvestment Act. And from the community side, my fear is that without the investment test, we will greatly dilute what we are seeing in real community development activity, and that those holistic community development activities will dwindle. And as Dorothy mentioned, we've created somewhat of an industry that does this type of activity.

I think that we are seeing an emerging industry, who is making a tremendous impact on real community development. And I'm afraid that we're looking at pushing the banks back into doing what is just comfortable. Even if we go with the straight community development test, there is a lot of activity that might be classified as community development that doesn't get to the real core of community and neighborhood revitalization.

Without special programs and special initiatives, a lot of this will become what is the status quo. Even the organization that I work for, the product that we started out with as our prime product, is now common place.

I believe it's organizations such as our's that taught the bankers that this was good business, that it made a lot of economic sense. Now the banks do it, so we are now out looking at creating and developing new programs and products, and have done a pretty good job of that.

Yes, we still do some of that core business that we started with, but compared to what our thrust is, it's minor. And I would really hate to see us push this investment test, or even a community development test to the realm that it becomes just that comfortable lending activity. Some banks are really good at small business lending activity, and they should really do a good job at that, and continue doing that.

On the other hand, that does not create and revitalize neighborhoods that are in distress. It has to be holistic approach, and we need to kind of push those strings to create that type of activity.

MR. CASANOVA: Debra, I'm kind of curious. Do you have any opinion on the weighting at all?

MS. REYES: I haven't really analyzed the weighting, but I do believe if you push it into a test that it is a 10 percent weight of another component, that there's no motivation. I think there has to be something real that ties the motivation to that. And as I said, you know, our partners are financial institutions. And while they, I think, are good corporate citizens, they still, even with our organization, like to stick with what is comfortable.

MR. CASANOVA: Comfortable.

MS. REYES: And there is that constant push.

MR. CASANOVA: Okay. Connie.

MS. CHAMBERLIN: Well, I think that both community groups and the lending institutions were agreed on the fact that one of the things that is tending to happen with some CRA activities, is that they are not really meeting community needs, that they're being packaged or created in some way just to sort of be able to count widgits. And I think there was a fairly uniform feeling that there needed to be a better way to identify those community needs, so that if there was going to be an investment, and it was doing the type of thing that Debra says, obviously, that gets a great deal of credit. If it's merely purchasing investments that have been packaged by somebody else, to say that, you know, we've done some community investments, then that may not actually be making any difference in the community.

And we talked about the need for somehow, and we didn't figure out how this should be done, but for the examiners to get a more comprehensive picture of the actual needs in the community when they were doing the examinations.

MR. CASANOVA: Let me go to Buzz, and then Earl.

MR. ROBERTS: Yeah. I guess the question is if you're going to propose a change like this, what's wrong with the current structure? And I guess, I would argue that the current structure really makes it hard to analyze community development activities by splitting community development lending, and community development investment into different tests. And so it places the form of an activity over its substance in terms of the overall framework. And sometimes, communities and institutions alike are frustrated because it's an exercise in filling a box, rather than meeting a community's need.

In addition, the qualitative elements of community development are really paramount as other members have suggested. And it is difficult to really give community development lending its proper consideration in its qualitative aspects within the context of a broader lending test, which is primarily quantitative in nature. And, by the way, where the volume of community development loans is small compared with the overall lending activity of a bank, so the idea is that a community development test would make it easier. It would make it easier for communities to get their own local priorities addressed. It would make it easier for banks to put together the right financing products to address those needs, and get the recognition for it. And it would make it easier for examiners to really evaluate the totality of what a bank is doing in community development, and really examine that against the community's own local context.

MR. CASANOVA: Buzz, in terms of evaluating particular community's needs, how would you propose a bank do that?

MR. ROBERTS: Well, I think there are several levels of sophistication there that could be scaled over time, but for starters, you know, different communities have different economic conditions. They have different kinds of housing stocks, different kinds of economic development needs. So that, for instance, a city that is primarily a single family home ownership town, and another city that is primarily a multi-family rental housing town, have different needs, and will need different kinds of financings, some of which may take the form of investments, others make take the form of loans, as appropriate.

Beyond that, I think many of us in the field are trying to develop more and more sophisticated analytical tools to really uncover those needs.

MR. CASANOVA: Okay. Thank you, Buzz. Governor.

GOVERNOR GRAMLICH: Well, I just wanted to ask Debra, she seems to be the strongest advocate of the investment test. Are there any circumstances you could imagine where, if you were a regulator, you would be willing to relax the investment test for an institution, and let the institution substitute something else? Would you stick your heels in the sand, so to speak, or could you see any -- introducing any flexibility into this?

MS. REYES: First, I have to qualify this answer. I used to be an Assistant National Bank Examiner for the Office of the Comptroller --

GOVERNOR GRAMLICH: All right. Fine. So your answer will be even more informed.

MS. REYES: And I do think that there is a need, based on individual communities for flexibility in weighting on the part of the examiner. And I think that's very appropriate.

I think in my view though, is if we totally go away from an investment criteria, that then there's no incentive for the examiner or the bank to focus on that. And so, therefore, you know, of course, I think there's room, there should be room in all examinations of this nature for the flexibility of understanding the community and the circumstance, so yes.

MR. CASANOVA: One of the questions that came up yesterday was if a bank invests, say in a CDFI in one given year, then what happens the next year when the examiners come in? Does the bank give credit for that, or do they -- or does the bank get criticized for not making additional investments? So that came up. Robin, do you have any comments?

MS. COFFEY: Yeah. That was one of the things we talked about in terms of, you know, a lot of banks have in their portfolios already a lot of these investments. And every examination cycle it's what have you done for us lately, as opposed to what are you holding. And I think we've gotten to the point in a lot of large mid-size banks where you're looking at millions of dollars, hundreds of millions of dollars at very low spreads, or at outright grants that you don't call grants. They're called investments, and at what point is this -- I mean, this is not sustainable. And I believe in CRA, and I believe our bank does it for a variety of reasons, but when you have to consistently look at, you know, making investments at zero percent for ten years, you know, we're calling them investments so we get credit under the investment test, but you know, let's not fool ourselves, these are grants. And I know we get credit for grants too, but the other point I wanted to make was we're -- I'm a member of a bank which owns multiple bank charters. Out of all the bank charters that we own, 26 of them, their entire assessment areas are upper middle income census tracks. There are no low mod census tracks, so it's very difficult for them to find investment opportunities.

You're talking about -- you know, then you're looking for the low to moderate income people. And yes, there are low to moderate income people in upper income census tracks. It's not a huge percentage, so you're looking for those organizations. You're looking for investment opportunities that can get at the people in your assessment area. And in a lot of these communities, especially in metropolitan areas where you're not looking at the center city. You're looking at your suburban areas. It's very difficult to find investment opportunities that reach your community, and it's a constant criticism that the regulators face, well, we face from our regulators because you're out there looking for things, and you're trying to make things that you would have done as loans. You're making them into investments just because you need that bucket filled.

MR. CASANOVA: My assumption is that on the -- in your particular situation, the lending test, you probably do pretty well. Service test, you probably do pretty well, but the investment test is what drags you down.

MR. FITZGIBBON: Yeah, that's the hard one.

MR. CASANOVA: Earl, did I miss you? I'm sorry.

MR. JAROLIMEK: Yeah, just a quick comment. And Debra, I certainly respect your concerns. I just want to observe that, but I -- the optional proposal I raised, I think might really serve both sides in that there's something absent from this discussion, which is market forces.

Banks are not going to survive in their communities if they're not meeting the needs of their communities. And if, in fact, investment needs are apparent, you know, they're going to be forced to meet them regardless of what their preference might be. So with the flexibility, and that was a word I heard earlier that I think is important here, would allow for is that, you know, it's not going to pit needs against each other in a community or an assessment area. It's really going to allow banks to kind of find their niche and do what's needed, do something they do well. And that's why I think the optional option would be palpable.

MR. CASANOVA: Jeremy.

MR. NOWAK: Yeah. Thanks, Manny. I know of many examples where I think the investment test has been quite useful. And our example where we are probably has more to do with equity investments in vehicles that provide subdata equity to businesses that may have a more difficult time getting conventional venture capital, but that's niche, pretty niche, and pretty context specific. And so I'm empathetic to the viewpoint that while sometimes the investment test is quite useful in a particular context, that the spirit in which it was put together has, in many instances, led Dorothy to -- has been not observed, and has led Dorothy to what you talked about, which is creating a mini industry to pool, to create -- to pool assets and create opportunities for meeting the investment test in ways in which there's often a premium, and there's really very little value added to community development.

Given that, I would -- I'm then supportive of the idea, and I think it's, you know, the devil is in the details here. I'd be supportive of the idea of something like a community development test, as a substitute for that, where one of the options would get at some of these investment issues, but that would be one of the options. And it would have a broad enough -- it would be -- and here I think is the devil in the detail problem. If it's too -- if it's not clear enough about what kinds of things are there, and then it's hard to hold anybody to anything that feels like quantitative standards, which was another problem in the last review several years ago of CRA. If it's, of course, too rigid, then it's not able to respond to, you know, market opportunities and context. But it seems to me that there's an opportunity now or at some time in the future to spend time crafting something that would meet, Debra, the quite legitimate things that I -- that you talked about, but at the same time would keep us in the right spirit of what this was all about, so I just want to weigh in on that. Thank you.

MR. CASANOVA: Jeremy, I'm kind of curious. In terms of working with financial institutions, are these financial institutions willing to think outside the box, work with you on your various products, and commit, you know, sizeable amounts of money?

MR. NOWAK: Yeah. I mean, we're $120 million CDFIs. We're one of the larger ones, with lots of different products, and four different kinds of pools that are priced differently based on product and risk, so it -- but your question is, there's some that have been spectacular, and there's some that have been less than that. And the -- and without -- and I think the real answer to your question has to do with changes in the financial services industry. And because of changes in the financial services industry, particularly as it relates to regulated banks, and what kinds of products, in fact, they specialize in, and where their companies' competencies in fact are, it does in many instances open up opportunities for them to meet requirements through the investment test, in fact, because of, you know, if one day Mellon gives up all its retail operations and its mortgage capacity, you know, it's no longer a mortgage lender, then how does it meet those obligations?

It could do that through a community development test, as long as there were several options for that, so you know, it's a quite varied picture, but the variation doesn't have to do so much with institution by institution. It really has to do with changes in the infrastructure of financial services, Manny.

MR. CASANOVA: Before I get away from you, there was -- you also had another comment about from the bank industry standpoint, it's very, again, expensive to try and achieve this outstanding rating. And you had some ideas about maybe trying to provide some incentives for banks.

MR. NOWAK: Yeah. Well, I -- you know, there's two parts to this. From the community side, there's a view that there's radical grade inflation, you know, that would make the ivy leagues blush. And then from -- I had to -- I'm sorry, Manny, you opened it up. From the bank perspective, the question also understandably is what's the big -- why go for an outstanding? Just, you know, what -- there's no incentive for it. And so then the question is, is there some common ground between those two perspectives. And the common ground would then be, and here we've got the devil in the details, what would the incentive be for getting an outstanding.

MR. CASANOVA: Right.

MR. NOWAK: Is it different kind of regulation the next time you're reviewed, and is it more efficient? Is it certain kinds of safe harbors? What would those safe harbors be? And I think community groups would have a variety of perspectives on that, but again, this would be including, I think, be quite wary of certain kinds of safe harbors. But this would, I think, at least be, it seems to me, an opportunity to look for some common ground between the perception of grade inflation, and the idea that we're not really well incentivized to do -- to be outstanding.

MR. CASANOVA: Okay. Thank you, Jeremy. Ruhi.

MS. MAKER: I think I totally agree with Jeremy, the devil is in the details. And my concern would be that if we have an investment test that's optional, banks cannot opt out in communities where there is need. And what Debra talked about is absolutely right, I mean, you know, in the early 90s when we first doing this, there were investments that, you know, people were like oh, really. We don't want to be doing it, and now it's like a no-brainer. However, there are no investments because there's a new -- new needs have been created, and we're moving along slowly. There are very creative things that have to get done, and we absolutely need investments. And, you know, you should not be able to opt out.

I mean, I feel like we're kind of the tail wagging the dog. I, you know, sympathize with your situation, Robin, but you know, most large communities, or even small -- what I think of as a smallish town like Rochester, Upstate New York, there are a ton of opportunities, and profitable opportunities. And I would be really concerned if there was a community development test, and yes, you could do your small business lending, or lend to a hardware store. And, I mean, we can't let the exceptions change something that has really worked well for many of our communities, and that would be my concern. So you couldn't say well, I can opt not to do an investment, so this is kind of hard. And it's not so much it's not -- there's work. When you first do it, there's work, and then perhaps there should be the commensurate reward.

One of the things that we hear from banks is that we come up with something innovative, and then it's innovative and we're continuing to do it. And then the regulators come back and say well, what did you innovate next, this time now? And I would say no, fine. If you're doing something innovative, it's working, I'm not -- I wouldn't certainly as a community group say, you know, to the Fed or to any of the other regulators, we don't want them to innovate something new every two years. If there's something innovative that's working, they should get -- continue to get credit for that, and I think a lot of community groups would agree with that.

MR. CASANOVA: Patricia, did I miss you?

MS. McCOY: Yes. Thank you. One area in which I'm sensing some common ground is interesting to see it unfold, is that we need to relax the geographic assessment area test. That would help accommodate Robin's problems, for example. And I -- CRA has always been criticized being anachronistic in its localist focus, and I think we've reached a point right now where we can afford to accomplish more investment by the simple expedient of relaxing that test.

MR. CASANOVA: Uh-huh. Well, that would certainly be a challenge for the Fed in how to write that, I guess, would be kind of interesting. Connie.

MS. CHAMBERLIN: Well, this is an issue that comes up with the question of actually establishing, perhaps, a community development test. And it was one that we didn't really get to talk about yesterday, but expressed great interest in, and I know there's concern on the part of a number of people. And that is, community development lending includes abusive loan practices, and I think the whole issue of not giving credit for loans that are actually abusive and damaging to the community, and perhaps even creating some sort of a system where you get a debit if you are damaging the community in that respect. And I realize that that's likely to be highly controversial, but I think we can't close our eyes to the issue of those loan practices in some of the most needy communities.

MR. CASANOVA: Connie, don't you think that would be picked up, perhaps in the Fair Lending examinations?

MS. CHAMBERLIN: I don't know that there is a specific mandate for the examiners to actually deduct for the quality of the loans. And I think that that's what we're looking at, not merely banks that can show that they're making a lot of loans in these neighborhoods, but going beyond that, and trying to determine whether those are actually abusive lending practices.

MR. CASANOVA: Are you touching on some like predatory lending type practices?

MS. CHAMBERLIN: That would be the word, yes.

MR. CASANOVA: Okay. Thank you.

MS. CHAMBERLIN: I was trying to avoid --

MR. CASANOVA: All right. Patricia.

MS. McCOY: Manny, thank you so much. Just to add to Connie's concern in that regard, we need to remember that to the extent CRA credit is given for abusive sub-prime loans, the government is providing an incentive for those loans, and so we have to take that issue of trying to remove that incentive very seriously. And the question then is what should banks do, as CRA regulated entities. And I would say at a very minimum, one of the problems we have in the sub-prime mortgage industry is a lack of compliance even with voluntary industry standards. For example, the Mortgage Bankers Association has such standards. We may amongst ourselves agree or not agree whether those are strong enough, but as a beginning step, I think an attempt by individual banks in the sub-prime area to enunciate their own compliance standards, and have internal controls to assure compliance with those standards, should be required before any CRA credit could be given to sub-prime loans.

MR. CASANOVA: Okay. I understand. Yes, Elizabeth.

MS. RENUART: Yeah. Sort of to bring together comments made by Pat and Connie, one problem with the CRA methodology is, when it looks at your geographical assessment area, the predatory loans may not be made in that area. They may be made outside that area.

In fact, there was one bank whose name I won't mention in Pennsylvania, who received a perfectly fine CRA rating because in its geographical assessment area, it wasn't making payday loans, but it was making them in other parts of the country, and they weren't part of the calculus.

MR. CASANOVA: Who was that?

MS. RENUART: I'll tell you later.

MR. CASANOVA: The discussion of assessment area, we're going to pick that up at the next meeting, so it's going to be pretty comprehensive.

CHAIRPERSON BROADMAN: I think Governor Gramlich has a comment.

MR. CASANOVA: I'm sorry.

GOVERNOR GRAMLICH: Yeah. Let me raise a question. We're -- the Fed, as you know, is not unworried about the problem of predatory lending, but I actually didn't want to ask about that right now. What I did want to ask about is actually something you said earlier, Manny, and it could, at least possibly, be an answer to some of the issues that a lot of you are raising about increased flexibility.

Conceivably, the strategic plan option could be used to deal with this, but you said that there was very little interest in that. And I would just like to ask why? I mean, because I could see this being an answer to some of the kinds of issues you're raising.

MR. CASANOVA: I don't know if I can answer that. I know there was only 35 comments that were received, and it seemed like the majority came from the community groups. And so if any community groups would like to comment on that, they were saying that the strategic plan should be eliminated. They said that the goals that were approved by the agencies were not stringent enough.

As far as the industry commentors, they said that the strategic plan provides an effective alternative method for evaluation; however, other industry commentors stated the plan option is not effective because it's difficult to develop a plan with measurable goals, so maybe that's where we ought to attack it from, trying to develop some measurable goals.

MR. JAROLIMEK: Governor, I might try to answer that. I think -- and I'll just give you the reason why our company hasn't imposed any option, and there's so many variable factors taking place, not only within say the structure of a company, the product delivery, the product line, the economy. If you look at last year, you know, lending goals would have been very difficult to meet in certain areas, but you know, on the other side, there was a large refinance volume taking place, so it's just -- it's very difficult to plan out that far in advance, and then be held to those numbers with the risk of, you know, trying to explain why, in fact, we didn't make that mark. It seems to me the CRA exam has more flexibility to allow for those variables.

MR. CASANOVA: Yesterday I think they made a comment that there were eight strategic plans, I think, that were filed with the OCC [Office of the Comptroller of the Currency], and I don't know how many were filed with the Fed, but it wasn't very many.

GOVERNOR GRAMLICH: No, it's very few.

MR. CASANOVA: Dorothy.

CHAIRPERSON BROADMAN: Yeah. Just in response to that question, one thing I think that is part of the strategic plan is that if an institution does opt for that, gets one approved and finds it doesn't meet its goals, that it's permitted to go back to the regulation, so that if the economy turns, or if your internal structure changes such that you can't make those goals, it shouldn't be a problem.

I think that from the industry's perspective, there's discomfort with the public process, the oversight process, and that that's kept many institutions from pursuing that option.

MR. CASANOVA: Uh-huh. Buzz.

MR. ROBERTS: I wanted to touch back on some of the geographic considerations that were being raised earlier. One of the great hallmarks of the U.S. Financial System is its ability to move capital from folks who have it into the people and places that can use it productively. And an irony of CRA as that system has evolved and been refined over the last couple of decades is that CRA can, in some cases, impede capital mobility. And this is less an issue, say, with single-family home purchase mortgages because of the extensive secondary market apparatus available for that. But community development finance doesn't fit into the existing secondary market structure well. Their volume and standardization problems really impede that, and so other folks have come together to figure out ways to move capital around, but CRA makes it very difficult to get banks engaged in that efficiently, and so we'd like to have some ways of addressing that problem.

MR. CASANOVA: Governor, going back to your point. What you're suggesting is something like in Robin's case, where they're having some difficulty fulfilling the requirements of the investment test, but that if they were to put a strategic plan together to eventually, you know, come into compliance then that's what you're suggesting, and maybe that would work. And the examiners could see that, and understand the particular situation.

GOVERNOR GRAMLICH: Yeah. I'm actually not suggesting anything. We're supposed to be listening, and not pontificating, but I was just wondering if that might be an approach that would appeal to people.

MR. CASANOVA: Robin, you have some thoughts.

MS. COFFEY: Yeah. I was the one who, I guess, defended the strategic plan yesterday for those banks who have gone through the public process and have gotten approval. I get to take away something that they perceive, and I know some of them in Chicago, Northern Trust, which believe it's a very good vehicle for them to accomplish CRA, given their business strategy.

I believe most banks, at least those that I talked with, have a real fear of the public process. It's one thing to be in communication with your regulators about what you're doing.

It's something else to be in communication with the public about what you're doing. Putting the two together raises a lot of concern for bankers about what they will end up. They feel, in some respects, they can manage the regulators, they can manage the public, but you know, all of a sudden you put these two together, and what are you going to end up with? What are going to be your goals?

MR. CASANOVA: All right. Agnes.

MS. SCANLAN: I just have a comment about that. One of the things that we discussed when we were trying to decide which way to go in terms of a strategic plan or another method is, we didn't want to go the way of a strategic plan, mainly because of what Earl said, the internal structure, a large institution, so many different states in which we do business. We're not concerned about, or have any problems with a discussion in public, because we do that all the time. Our institution has to do that all the time in public, but it was more of a concern of the fact that our organization has changed so much in the business structure, and the fact that we're in so many different geographies that we didn't think that a strategic plan was the best way for us.

MR. CASANOVA: Thomas, we haven't heard from you, and I know you had comments.

MR. FITZGIBBON: Well, I just -- one of the concerns, getting back to the investment test is -- for a minute if I can, is the sort of unspoken, unarticulated ceiling of what is adequate and what is inadequate. And that that, to a certain degree, leads to the creation of instruments that are form over substance, Buzz, as you were saying yesterday, which is this could be a loan, but you know, for abundance of making sure that we've got enough because we don't know when is enough, we'll -- we'd rather make an investment. So converting what would have been sort of normal business transactions into aberrated sub-debt, the investment types of instruments that really don't have any value, but are sort of created to address this unspoken investment test ceiling that is out there. And I think again, what it does is it just sort of aberrates the system, and that was a concern I had on that, as well.

MR. CASANOVA: Very good. Yes, Connie.

MS. CHAMBERLIN: Just one more thing having to do with the difficulty of determining what the community needs actually are, and the lack of real data that is out there. And Jeremy made a good point yesterday when we were talking about that, about how the examiners --

MR. NOWAK: Oh, yeah, performance.

MS. CHAMBERLIN: -- talk in the community. And I wondered, Jeremy, if you'd make that point again.

MR. NOWAK: I'm shocked that I made a good point. I just said that in all too many cases, and we've been certainly as guilty of this as anyone, we assume we know what is going on based on conversations with, I think I used the term "the usual suspects", saying that I was, in my context, one of those usual suspects. And that very often we don't spend enough time looking at real market data to have a sense of what kinds of needs, or what kinds of opportunities there. And so this creates a kind of community development that if we're not careful, becomes pretty stale in terms of product innovation, and in terms of its ability to reflect real market opportunity. And so I gave two examples in Philadelphia, that when we looked and did a pretty rigorous analysis of data, we saw some interesting opportunities with sub-prime home equity loans. And we saw not only in the city, but frankly for low moderate income people in the suburbs, and we also began to ask some really tough questions about where -- as we look to foreclosure data, recent foreclosure data which is escalating in Philadelphia in just significant ways, we began to ask some questions about why that is so, and under what context is pushing home ownership too low in terms of income a problem, and under what context is it not a problem? And so, I would just sort of ask that for all of us, that we occasionally take a deep breath, assume we don't know what's going on out there, and spend a lot more time looking at information as opposed to questioning existing constituencies, whether they're lenders, community development institutions, or heads of public agencies. And my own sense, I do travel occasionally around the country and get out of town where I am, my own sense is that this is a kind of a self-reinforcing process that goes on.

I used the term yesterday that, you know, there's a tendency for all of us to genetically reinvent ourselves in terms of our own organizational codes. You know, we sort of -- we reproduce ourselves in our own thinking, and it's quite important to occasionally step back from that, so that's just a -- I think a problem for all of us in the community development world. I mean, you know, predatory lending in a certain funny way is a good example of it. It just -- it hit -- there was an entire market place of these third party arrangers going on underneath the radar screen, and we could all admit, of everybody who was doing this kind of work, and that's because we actually didn't understand our market place, and the dynamics of our market place in many instances as well as the predatory lenders did. That's a problem, and that says something about what we've got to do.

MR. CASANOVA: Dorothy.

CHAIRPERSON BROADMAN: I think we may be transitioning into a performance context discussion, because I think that's really what you're talking about. But before we go there, anyway I wanted to make another comment about the investment test, and also just to say that predatory lending is not a new issue. It's been an issue for a long time, and there are community groups that were studying it and reporting on it before it became such a hot issue, so perhaps it's a bigger issue today. I don't know, but it's unfortunately been around a long time.

But in terms of the investment test, I think one thing I wanted to talk about is the impact this has had on the grant making process within financial institutions. I think it's important for people to know this. What seems to have turned into the idea of wanting to get credit for the grant making, the community development oriented grant making work that banks are engaged in, it's developed into, I'm not sure how to say this, but a focus on making sure that a certain portion of the grant making goes to community development purposes. And I don't think that's the intention, but that has been the affect. And I know, because of the pressure on banks for dollar volume, although as Tommy says, we don't know what that is. We just know it's there. And so, as a CRA Officer in my last position, I would get responses from the people that manage philanthropy, the policy making side of philanthropy for the institution, they would ask why are the regulators telling us where we should be placing our philanthropy? And I don't think that's the intention of the agencies, but that's what has evolved, and that's what's come across, so to me that's another reason to support the idea of flexibility and options.

MR. CASANOVA: Very good. Hubert.

MR. VAN TOL: I wanted to ask Buzz -- you know, you brought up this whole idea of replacing the investment test with the community development test, and I think that is an intriguing idea, but how would you structure that in a way to address some of Debra's concerns so that, you know, it wasn't just community development lending, and the investment got set aside? Is there a way to do that so that when community development needs are met in assessment areas, you know, it could trickle over into other areas, as well. You know, I know you must have thought about this a lot more, so you have more thoughts on that.

MR. ROBERTS: Well, I think it would be possible, for instance, to have more than one element to a community, within a community development test. You can take a look at community development lending. You could look at community development investments, community development services. And by having a formal way to -- for examiners to really look at each of those elements, I think that would encourage the proper attention to each of them, rather than just having an omnibus community development test without any differentiation.

In terms of the geography, there is under the for wholesale and limited purpose banks, generally a single test under CRA, and that is a community development test, under which if the institution is adequately addressing its assessment areas needs, then it does get recognition, full recognition under CRA for activities taken, undertaken elsewhere. It's under no obligation to do that, but if it chooses to do that, it gets recognition for doing that.

It seems to have worked well on the wholesale, for the wholesale banks. And it's certainly enabled us to get money into places like rural Kentucky, where no retail bank had an assessment area that included that part of the world. And the retail banks, at least the ones with sufficient sophistication to undertake the activity, and the outside institutions, the outside retail institutions with sophistication and capability to undertake the activity weren't interested because they wouldn't get CRA credit for it.

MR. CASANOVA: Okay.

MS. REYES: If I might comment as a follow-up. I think my position is, is while I think there's a need maybe for overall re-examination of the investment test, and I think possibly this community development test with some components is a viable solution. My fear again is though that we weigh it very cautiously, that we not dilute the value of the investment or the lending, and that we not take out true community development activity as opposed to the status quo lending activities.

And again, I would go back to the banker's side having been a banker, I understand the geographical limitations. And I think as we look at this whole scope, that there is some value to looking at how we put this whole program together in these upper income communities that we've talked about, and in some cases where there are no investment opportunities for low and moderate income. I think we need to really look at what's needed.

These middle upper income communities are provided services by low income individuals. These low income individuals in some of these markets are actually bussed from communities that are very, very poverty stricken. And these are the issues that need to be addressed by real community development activity, and not again, a status quo activity of doing what we're comfortable doing.

MR. CASANOVA: Okay. Very good. Yes, Dorothy.

CHAIRPERSON BROADMAN: Yeah. I think you raise a really good issue, and I'm not sure we've talked about this here, but last year we talked about one of the frustrations of industry people who are supportive of CRA is that it's become such a numbers game, and we're spending so much time chasing the same credit that would already have been made, and reducing pricing. And that we've lost a focus on the high impact important community development work, and so listening to you has reminded me of them. I think what we want if these regulations are modified, is we want incentive for doing the important high impact community development work, and it may be innovative or it may not be innovative, but it's high impact, and that that's where we should focus, and we should get extra credit for doing that kind of work so that the incentive is there.

MR. CASANOVA: Okay. Very good. Anything else in the investment test? I did want to move on and touch on a couple of other things. Anything else?

Okay. There was some discussion briefly about data collection and maintenance of public files. We just touched on that briefly, but what I found interesting is that, although not surprising, the industry commentors found maintaining a public file to be burdensome, especially since very few, if any, interested parties asked to see it. And I can suggest, like in our particular case where we have, you know, 20 branches, we have a public file in every branch. The argument is why don't we just have it at the main bank, and if any community groups would like to see that, we just contact the main bank.

The community groups for their part, as far as the public file, they did find that file very important, very informative, and so, you know, the public file from their viewpoint is essential in understanding what a bank does with regards to CRA activities.

And the other comment regarding data collection was that some community groups wanted CRA data to be more like HMDA data, which as a banking industry, we certainly don't want to go that route. But, Earl, do you have any comments about that? I know you didn't particularly care for that, but --

MR. JAROLIMEK: I'm becoming the data collection spokesperson I think.

MR. CASANOVA: Yes.

MR. JAROLIMEK: You know, I think -- and this really kind of -- we have a lot of data collection issues in front of us today, and I think, you know, this might capture many of the subjects we're talking about. I think there's a premise that more data is always better. And I guess I would just, you know, counter that by saying that quality data is good for everyone. And I'm not sure that volume equals quality, and I think that's a real concern here with no only the CRA, but the other subjects we're talking about. And I guess at the end of the day, it's really -- if we get more data, at what price do we get the data or obtain the data? And right now, the price is being borne by the industry, and we're really having a hard time coming to grips with the proposals that affect that, is that if the value was very apparent, it might be very easy for us to say yes, let's go ahead and contribute. But when the value is so much in question, the price seems to outweigh the activity, and I would suggest that would pertain to the CRA collection, as well.

MR. CASANOVA: You can an example yesterday about your particular staffing situation, where you have so much --

MR. JAROLIMEK: Yeah, we had the OCC in for three weeks to do a data integrity review on our HMDA data and our CRA small business collection that we've done in the past for the year 2001, a very painstaking process. And I tried to kind of put this into perspective by saying we've got -- I've got a staff of nine. We have two priorities, and the rest of the compliance concerns, quite frankly, take on the rest, but the two priorities are real estate lending, given the complexity of a real estate transaction, and the other priority is CRA data collection.

It is extremely time consuming for us to have to go through each of the files and make sure the data has been collected properly, not only for HMDA, but for small business, so we spend an enormous amount of time and resources in doing that. To add to that would, you know, something is going to have to give, and I'm afraid it's going to be the other compliance regulations we'd like to meet as well, so --

MR. CASANOVA: Thank you. Ruhi.

MS. MAKER: I would like to talk about small business data. We have cut small business data since it's been available, but obviously, at the aggregate level is where it's available at the census track level. The banks already collect and give, I assume, to the regulators small business data at the census track level. And I know some arguments have been made about confidentiality, et cetera, but we've seen significant changes in lending to people of color, and to minority communities where the race data has been collected with HMDA data. And we haven't seen those same changes at the small business level, because it is aggregate and somehow it just -- you know, Tommy made a point well, if there's no lending going on, you go to all the banks and say you're not lending. But somehow, for whatever reason, it hasn't quite worked that way. And I would really -- you know, maybe we would -- you know, obviously, there would have to be greater discussion about this, but at the metropolitan level when you're talking about a large -- you know, even a community like Rochester again, I give the example, which is I don't know how much confidentiality would be revealed if you revealed small business data at the census track level, which is already collected. I think there would be a lot of value to that, and I would really certainly encourage that.

MR. CASANOVA: Ruhi, before we leave you, you had a comment yesterday about examiner training.

MS. MAKER: Yeah. I would say, you know, 20, 30 exams on it, keep -- you know, since the mid-90s it's early -- there is really, I think, a lot of inconsistency in the quality of the examiners that I have met. And we're -- our procedure is very straight forward. We note if there's an exam coming up. Usually, we'll contact the regulator in question, and they'll come and see us, and we'll sit down and we slice and dice the data at the very detailed level. We have data going back. And, you know, if somebody's coming up from New York, if somebody's coming up from New York City, you know, they really -- for them, you know, Upstate New York sometimes might just as well be another part of the country. They have very -- you know, they're very surprised. They don't really have a sense. And so training, I think, is really, really important, and consistency across agencies.

In my experience, it isn't consistent across agencies. I think that's a concern. And I have found a value in having people come back, you know, repeatedly over a couple of years. I know, Jeremy, you made that point that, you know, it can get jaded. But I thought about that. Often there are supervisors who can be different, and you can have a supervisor who is different, but you know, looking at a Chase, or a Citi or a bank like that, they're huge. And, you know, you aggregate the data for the entire assessment area, and you know, you may pick up New York City, but you know, Buffalo, Syracuse, forget about it. I mean, they're -- really you can be doing nothing there I feel, and still get an outstanding because you can't see, you know, the wood for the trees or vice versa. And I think that's a real concern for us, so we would really encourage examiner training on all aspects.

MR. CASANOVA: Thank you, Ruhi. Agnes.

MS. SCANLAN: I would completely echo that. We've seen that in many instances, inconsistencies amongst the agencies as well as within one particular agency. And certainly, we have work in New York City, and there's always an understanding of well, what does it mean for Upstate New York, the same thing for New Hampshire, so there needs to be, I think, more consistency on training. We actually saw that with the investment test. One agency looked at one category of the investment test, and we were weighed differently, as opposed to another agency looking at the same thing, so I think that there should be more consistency in the training, and more interaction between the two.

MR. CASANOVA: Okay. Thank you, Agnes. Yes,

MR. FITZGIBBON: I just have a couple of follow-up issues that Earl had brought up yesterday in terms of the data collection, as well, and that's two things. One is that we really need to go back and look at the purpose. What is the purpose of gathering the information, especially on small business and small farm types of financing? What was it supposed to do for us as a community, give us what information?

I think we need to look at that more intently as we explore whether, you know, additional level of detail is exposed. And the second is that not all community lending is disclosed. I mean, part of the problem is that there are certain areas of lending that aren't captured either in HMDA or in CRA that are very important to the overall health and vitality of the community. And I pointed out our particular experience in Chicago with making loans on two by fours, typical residential street with two retail shops on the first floor, and three or four units of rental above. It's not captured either in CRA for small business, or is it HMDA because it falls through the cracks. Yet, it's a very important segment.

Yes, you could make that disclosure as other loan criteria on your -- and it is in the performance evaluation, but you know, I think we have to understand that data collection is imperfect, and that we need to really explore whether or not additional level of detail is really going to give us anything of value.

MR. CASANOVA: Okay. Thank you, Thomas. We just have a few more minutes. One thing I wanted to touch on was definition of a small bank.

MR. FITZGIBBON: Yes.

MR. CASANOVA: We did talk about that.

MR. FITZGIBBON: Right.

MR. CASANOVA: And basically, Staff wanted us to bring it up in the Committee yesterday, and their questions are should the definition of a small bank be expanded?

Under the current rule, "A bank is not small if it is, (1) Has more than $250 million in assets, or (2) Is affiliated with a holding company with a $1 billion or more in assets." And after some -- I guess empirical data that was shared with us yesterday, I daresay there was some consensus that $250 million threshold was an acceptable threshold. However, there was some discussion that maybe the holding company rule should be eliminated. And I know, Robin, you had some, I think, some thoughts on that. Did you?

MS. COFFEY: Yeah. And again, because we have multiple charters, and quite a few of them are less than $250 million, but they're still held to the large bank test, which is why investments in affluent areas become very difficult when you're a $50 million bank, but you're still expected to do sizeable investments, which gets into your grant making.

MR. CASANOVA: One of the reasonings behind the $1 billion rule is that there's an assumption that the holding company will be supporting you on investment type products, I guess, but that's not true, I guess, necessarily.

MS. COFFEY: And Earl also talked about this. You know, there may be some expertise available, but for example, I'm in Chicago. I also have a bank in Florida. I'm an investor in Debra's Fund. I also have a bank in Arizona, but the expertise resides in Chicago, and trying to come up with community development lending and investment opportunities for those now $75 billion banks in those two locations is extremely difficult. You can't afford to have a full time community development person on staff at those banks to generate loans and investments.

MR. JAROLIMEK: And, Manny, Robin speaks to structure. I think many of the institutions or holding companies that have institutions that are small tend to operate under very independent nature in that these banks and their communities are very independent of each other and the holding company. It's merely a structural arrangement as opposed to having that type of tops down investment approach.

The numbers were kind of interesting as a -- and I don't know if these are -- have been validated, but I think from a preliminary look we saw that 85 percent of large banks would remain large banks if the holding company definition were removed, so that's a pretty substantial number compared to today's number.

MR. CASANOVA: Okay. Any other --

MS. MAKER: We were going to touch on performance context and affiliate activities?

MR. CASANOVA: Go ahead, please.

MS. SCANLAN: You know, I mean coming back to the dread "P" word, the predatory lending word, you know, if you've got a lender who's doing all their activities through -- either through their affiliate or some other way, and they're doing their sub-prime in the low mod, or the African American community, or the minority community, and they're doing their prime in the affluent white community, you know, I really think that that's something that has to be looked at. I mean, predatory lending is -- I mean, there are days when I feel that the seven, eight, nine, ten years of CRA work that I've been doing has probably all been undone, and that's what I'm going to be spending the next three years trying to fix.

We just have -- we have gone back. We have lost everything that we've gained. I mean, there are really days that I feel like that, because being in a law office and having to represent actually the victims of the people who got the CRA loans five years ago whose equity has now been stripped, so I think that is absolutely something that the Fed can play a role in, all the regulators can play a role in. And take a very hard look at what some of these financial institutions are doing, and say, you know, as a public policy issue, you know, we're devastating our inner communities. And, you know, if we continue in a recession or if things get worse, if we go into a war, you know, we haven't seen anything what -- you know, what the inner cities are going to look like. It's very frightening for me at least, being right there on the ground. It's very frightening how the whole structure is going to fall apart, so that would be my thoughts on the performance context.

MR. CASANOVA: Earl.

MR. JAROLIMEK: Yeah. And I'm not sure this fully answers your question, but I think from a predatory lending standpoint, given that the Fair Lending exams that take place in institutions today that typically preface a CRA exam. In other words, part of a CRA performance is based on a bank's Fair Lending performance. And to the extent that would include pricing, other Fair Lending practices, I think much of what you're concerned about is already captured. It may not be everything that's "predatory", but a good share of it, I think is already being addressed through the Fair Lending exam process.

MS. MAKER: All my clients, you could not -- you would not know that the paper is scant just by looking at the paper.

MR. CASANOVA: Lester.

MR. FIRSTENBERGER: You're not suggesting that also prime loans equal predatory loans.

MS. MAKER: Absolutely not.

MR. FIRSTENBERGER: Okay.

MS. MAKER: We must have some prime lending. Risk base pricing is absolutely key to the inner city community.

MR. FIRSTENBERGER: Correct.

MS. MAKER: I'm never going to suggest that. In fact, more responsible lenders need to do more risk base pricing. I mean, I think that's where -- you know, I would go to any of my lenders and say do risk base pricing. Thank you for doing risk base pricing. Absolutely.

MR. CASANOVA: All right. Yes, Dorothy.

CHAIRPERSON BROADMAN: I just have a question for you, Ruhi, on that. I'm not sure what you're saying. Are you saying that this cannot be uncovered in a Fair Lending exam, but it can be uncovered in a CRA exam?

MS. MAKER: Well, I think the Fair Lending exam, for example, I never seen it. I mean, we always request do a Fair Lending exam, but it's never made public. And, you know, as we're starting to uncover some of these things, we would raise them with the examiners, but I don't know how -- I have no idea what the Fair Lending exam constitutes, so you know, it's -- I'm not really sure how deep the regulators are going, who they're talking to.

MR. FIRSTENBERGER: So you want to use the CRA exam as the Trojan Horse to get in and be able to do Fair Lending examinations on a private basis.

MS. MAKER: No, I'm not. All I'm saying is that, you know, if you're getting CRA credit for making what are essentially predatory loans, or if you're getting CRA credit for making sub-prime loans when you should be making prime loans, because that comes back to some of that discussion we had as to what the mortgage brokers are doing, you know, that shouldn't be happening. And I think there needs to be a --

MR. FIRSTENBERGER: Presumably, though, the examiners are already saying it's either a predatory loan or not a predatory loan. They're making that -- they've already made that determination.

MR. JAROLIMEK: No, that doesn't happen.

MR. CASANOVA: Yes, Patricia.

MS. McCOY: Well, I think we all realize that racial profiling, other discrimination on prohibited grounds is one aspect of predatory lending, but in other respects predatory lending can very much be color blind, and yet be exploitative, so Fair Lending examination will not perfectly capture the problem.

MR. CASANOVA: Okay. Very good. Well, we'll continue this discussion at subsequent meetings. Any other comments or questions about investment testing.

CHAIRPERSON BROADMAN: A few more minutes you can take.

MR. CASANOVA: Thomas, I'm sorry.

MR. FITZGIBBON: I just -- so we don't miss it. On the service test side is that we did do -- we had some discussion on the service test side that related primarily to looking at what types of activities would be considered in the future on the service test side.

MR. CASANOVA: Okay.

MR. VAN TOL: And I just wanted to make sure that the fact we didn't get to assessment area issue in detail yesterday was not construed as --

MR. CASANOVA: Ignoring.

MR. VAN TOL: That we didn't think it was important.

CHAIRPERSON BROADMAN: Just we mentioned briefly the public file, but didn't talk about it too much. I just quickly want to say, I think it's one area where we may have actually had some agreement in that.

MR. FITZGIBBON: No.

CHAIRPERSON BROADMAN: No, we didn't?

MR. FITZGIBBON: What was the agreement?

CHAIRPERSON BROADMAN: Let me try it. I knew that would make some people wake up, and that is that we don't need to continue this requirement that every branch has this -- the version of public file that's required at this point, but that a person in the community has to have the ability to go into a branch and request a copy of the public file, and that there be some standard that it be delivered within some -- Connie said some time frame. And the idea behind that is that I think for those of us industry, we either never or extremely infrequently get any requests at the branch level, and that it's really not so much an issue of burden. But I also said yesterday that I think if the environmental groups were paying attention to this, they would be objecting to it.

MR. FITZGIBBON: Absolutely.

CHAIRPERSON BROADMAN: Because it is very wasteful.

MR. TORRES: And I think we also mentioned that another way to provide the information might be over the Internet in a file.

MR. VAN TOL: And the industry is going to provide computers to everybody.

MR. TORRES: Well, I'm not saying that should be the exclusive way to do it.

MR. VAN TOL: We have the local library.

CHAIRPERSON BROADMAN: Who gives the okay for that?

MR. NOWAK: Did you want to try a resolution, Dorothy, on that?

CHAIRPERSON BROADMAN: No. Definitely not.

MR. CASANOVA: Okay. Well, I guess that concludes our discussion here.

CHAIRPERSON BROADMAN: Okay. Thank you, Manny. We will now gather for our photo, and reconvene at 11:20.

(Whereupon, the proceedings went off the record from 11:02 a.m. until 11:28 a.m.)

CHAIRPERSON BROADMAN: Okay. We'll reconvene the meeting. We have a great opportunity to hear from one of our Council Members during this Members' Forum. And Robert Cheadle who is from the Chickasaw Nation will be educating us on financial services in Indian Territory.

MR. CHEADLE: Thank you very much. I appreciate this opportunity to speak to you all about financial services in Indian Country. And if you don't mind, I would prefer to remain seated, if nobody has an objection.

It's our tradition to pay tribute and homage to our family and tribe, and I would like to thank my sister for coming today and lending her support. Please raise your hand. Thank you.

You have heard from Indian Country for many, many years that we are one of the poorest communities in the United States. In 1994, Congress stated that many of the Nation's urban, rural and Native American communities face critical social and economic programs arising in part from the lack of economic growth, people living in poverty, and the lack of employment and other economic opportunities.

To support that, I want to give you some statistics from Indian Country. When surveyed, 65 percent of Native American and Native Hawaiian respondents reported that conventional mortgages are difficult or impossible to obtain. Business loans were rated as impossible to obtain by 24 percent, and difficult to obtain by 37 percent. Sixty-seven percent of Native American and Native Hawaiian respondents said that private equity investments are difficult or impossible to obtain. And the difference, the investment gap between Native American communities in the United States overall totals about $44 billion, so in 1994, Congress created the Community Development Financial Institution Fund. It is a wholly owned government corporation inside the Treasury Department. The mission of the CDFI Fund is to expand the capacity of financial institutions, to provide capital, credit and financial services in under-served markets.

The CDFI Fund has taken a lending survey over the last few years, and they issued a final report in November of 2001. That final report was premised upon a statistical survey that was compiled by Deloitte and Touche, that was published in December of 2000. We are very appreciative to have this kind of data available, and it is -- these two reports are the source of the data I'm going to present today.

Now I'm going to give you a lot of information. There's too much text on these slides for me to read to you, and so following this presentation, there will be available on the back table there hand-outs which are these slides for you peruse. These reports can be located at WWW.CDFIFund.Gov/Native American Programs, final reports. The methodology that they used was they held 13 regional workshops at a national roundtable which mainly considered equity investment.

The questionnaires that were mailed out to tribal organizations numbered 735. The return rate was 25 percent. They mailed 851 to financial service organizations, and the response rate was 33 percent. The CDFI Fund expressed disappointment in the low rate of return from Indian Country, but I'm here to tell you, I'm very happy with 25 percent. Usually, you get a return rate of lower than 10 percent.

The final report identified four general findings. I'm going to introduce you to three of those today. This is the number one general finding, and we're going to pay the closest attention to this one because it is so pregnant with barriers and potential remedies. The most significant barriers to lending are obtaining financial services and products, concern lack of collateral, tribal members lack of understanding of the financial world, inefficient state and federal programs and regulations, and insufficient or non-existent tribal commercial laws and regulations.

Legal infrastructure barrier was identified as inadequate tribal commercial laws and regulations. This barrier is particularly dear to my heart because this is the piece of this situation that I am employed in. This is the area that I'm trying to provide some of these potential remedies, establish tribal UCCs, foreclosure regulations, bankruptcy codes, et cetera, zoning codes, and land use plans, and educational programs for lenders and investors on tribal government laws, codes, sovereignty and sovereign immunity.

Government operations barriers have been identified as cumbersome, conflicting, ineffective federal or state programs and regulations, inflexible banking regulations, uncertainty generated by changes in tribal government.

I want to give a private, or a public thank you to the Fed today. The Chickasaw Nation recently developed a holding company which purchased an existing bank in Oklahoma. The Fed did its homework, found that it needed a little comfort that this Native American owned bank would be subject to Federal regulations. They asked us for a limited waiver of sovereign immunity, which was the correct document to ask for. We issued it. We have purchased our bank, and we are now in business, so I appreciate the Fed doing their homework and taking care of business to allow us to purchase that bank.

The potential remedies include several items that go to tribes themselves, including improving their planning processes, separating tribal government from tribal businesses, which is not always possible because of governmental organizations. There are about 535 federally recognized tribes in the United States, and they are all unique. Some of the tribes, such as the Chickasaw Nation, are patterned after the three-part government of the United States. Other tribes are organized as corporations. Other tribes are managed by business committees. Other tribes are theocracies which are actually run by people considered spiritual leaders.

Economic barriers. The first bullet there is limited use of trust land as collateral, and this is probably the first issue that has ever raised to me how do banks perfect an interest in trust land, for example, and these are tough issues to resolve. However, I am today going to tell you about some success stories. There are some creative methods being done out there, and they are resulting in, since banks are concerned with risk, they are resulting in profits for banks, so this is -- we don't feel like Indian Country is an area that should be avoided at all, or feared. It is a place where we can go into and do standard business.

In fact, the Seattle Fed has held meetings over the last several years, and there is a bank in that area, Washington Mutual, which has been successful in providing some mortgage lending on trust lands in that area.

Financial and fiscal infrastructure. The survey found that financial service organizations need to establish more local presence. To give you an example, the Navajo Nation is the largest Indian Reservation in the United States. It's in the four corners area. It's larger than eight states. Up until the early 90s, there was no banking presence whatsoever on that reservation. In the early 90s, they had one. In the middle 90s they had four, and that is the current stage of progress, at least in the Navajo Nation as to the number of local FSOs.

We thought in the survey that developing regional FSOs might be helpful in addressing some of the issues, but whatever happens, the relationship between the FSOs and the tribal governments must create innovative strategies in order to develop the Native American lands. Number two, please.

The second general finding is there is a significant need for education, training and technical assistance to increase the financial literacy of Native American communities. There's been a lot of talk lately about financial literacy, and how to educate people in order to become more knowledgeable.

In fact, last year at the research conference held by the Fed, Chairman Greenspan gave a keynote address, and that was his subject matter, increasing financial literacy. He suggested that programs be developed in the elementary and secondary levels of schools. I suggest to you that in Indian Country it needs to go beyond that. Even in the Chickasaw Nation, where we pride ourselves as being one of the most progressive and sophisticated tribes, we have moderate and high income citizens who are yet to be banked. They are unbanked. They still operate cash on hand. What little money they can save is in the Mayonnaise jar, or under a mattress somewhere.

Next please. The barriers are lack of knowledge or experience with FSOs. Historical absence of trust between the tribes and financial services organizations, and I want to call your particular attention to the last bullet. Yes, there still is some red lining out there. We still do have discrimination, and maybe that red line has become a little bit fuzzier, but it's still there. The next one, please.

Educational and cultural barriers, potential remedies, expand financial education for Native Americans, expand entrepreneurship programs for Native Americans, conduct lender and investor education programs, so the education needs to flow both ways, both from the financial industry to the Native American communities, and from the Native American communities to the financial services organizations.

General Finding Number Three. Conventional home mortgages are consistently identified as one of the most difficult products to finance on Native American reservations or Indian lands. I want to tell you about a very large success story, and it is called Chuka Chukmasi, which in the Chickasaw language means Home Beautiful.

PMI came to visit the Chickasaw Nation in 1998. We sat down. We developed the first Native American specific mortgage product. We put together a team to deliver this product that was in the very beginning made up of PMI Mortgage Insurance Company, the Chickasaw Nation First American Mortgage Corporation, a Native American owned mortgage broker in Kansas City, Kansas, FT Mortgage, which I don't think they ever really completed one, so Washington Mutual stepped in, and Freddie Mac purchased these on the secondary market.

The program at the Chickasaw Nation earned the Social Compact Awards, and HUD's Best Practices Awards in 1999. Three other tribes in Oklahoma immediately picked up the program, amended it to their own uses, and some of those have also received HUD's Best Practices Award.

Today, PMI has carried that program forward, and it has spread from Michigan to California, from South Dakota to Oklahoma, with over 1,000 mortgages closed on the ground in Indian Country, both fee simple and trust land. It can be done. It is being done. Next, please.

And before I leave that subject matter totally, I want to give a very heartfelt thanks to Roger Howton, who is President and CEO of PMI Mortgage Company, and Gene Garrison who drives the train for PMI, and for spreading that across Indian Country.

Key initiatives for the Federal Government include facilitating linkages to financial markets, facilitating the creation of public and private equity investment funds. Next, please.

Next, Americans -- next -- excuse me. I'm going too fast for myself. Native Americans Next Steps. Develop competent credible court systems and commercial laws, develop rational, predictable rules for the operation of sovereign immunity in business transactions, such as we talked about our relationship with the Fed. Next, please.

The FSOs, we would like them to develop more local presences, and help develop educational programs, develop flexible products, think outside the box. And I wish we had another cliche, I'm getting so tired of hearing that, think outside the box, but that's exactly what we need to do. Next, please.

Bottom line. Cooperative activities. All progress to be made in Native American communities will depend upon tribal governments, federal agencies, and financial institutions working together. We must do it together for the benefit of the Native American communities, for the benefit of government operations, and for the benefit of the finance industry. Next, please.

Again, I would like to thank you very, very much. I was going to tell you that this is a traditional Chickasaw pattern for rugs, and we have little old ladies sitting under trees weaving these things, but I knew you wouldn't believe that, so I'm not going to. Thank you very much, and in my language Yakuke.

CHAIRPERSON BROADMAN: Thank you, Robert. That was very informative, and much needed. And I have to say, the most aesthetic slide show I've ever seen. And I have to tell you this. I hope I don't embarrass you, but he told me that he taught himself Power Point at the same time as he created this presentation for us, so a tremendous success. Thank you.

We'll go back to the agenda of our meeting. I'll turn this over to Jeremy Nowak, who will take us through the discussion of the Equal Credit Opportunity Act.

MR. NOWAK: Did you -- I know there was some though, Dorothy, about changing the order, but we're going to stay with the order, do Committee Meetings first?

CHAIRPERSON BROADMAN: Stay with the order.

MR. NOWAK: Okay. Thank you. Thank you very much, and thank you, Robert. Those of us that are on the Community Affairs and Housing Committee have had the benefit of Robert's input on these issues, and it's from a Native American perspective, and it's enriched our Committee significantly, and so it's great to see this. Nobody -- you're right. No one will want to do a follow-up Power Point presentation is our problem.

Our Committee dealt with some important issues here related to ECOA [Equal Credit Opportunity Act] Reg B. And there were three issues in particular that we spent time with. One has to do with removing the prohibition on data notation for non-mortgage credit, and we want to deal with all of these issues. I'll just run through them and say a word about them.

A second has to do with retaining records for pre-screened solicitations, and a third has to do with the definition of a creditor, particularly as it relates to third party transactions, arrangers, participants in extending credit. And we had a pretty, once again, spirited conversation, which I think will be reflected in the comments that we will all make now.

On the issue of removing the prohibition on data notation for non-mortgage credit, there were lots of different perspectives. Many of these revolved around the question of should it be voluntary or should it be mandatory. Or, of course, should it happen at all, and if it is mandatory, whether it be mandatory around particular kinds of products. And part of the question here was what are we trying to get at? What kind of data? Data for what? Data for whom? What is the cost and the benefit of this? And for many of the people from the industry side, there was this question of what are the reputational risks of doing it, versus not doing it. And from the consumer side, there was obviously high level support for getting as much data as possible, and making it mandatory. It wasn't universal, but there was quite a bit of support from that perspective, so I'll come back to that in a second.

The second issue had to do -- that we spent the most time with, had to do with the question of the definition of a creditor here. And here, probably the core issue or the core question had to do with whether the -- on the industry side, the industry was feeling like they were being made to be de facto regulators, and we were creating the potential for a significant amount of litigation or liability. And that if we leave it in the way it is right now, there was this question as to whether it is too vague. But, of course, if we were to make it less vague, we would have to create some kind of a bright line. And then, of course, we had no agreement on how bright or dim that line ought to be, so there was this question about what are we trying to get at? What is the right regulatory infrastructure for getting at it? And given the proliferation of an extraordinary amount of arrangers out there that are in many instances not subject to effective regulatory practices at the local and state level. I think there was actually some agreement, although no resolution, agreement to that point, how do we get at this problem of regulating or dealing with the liability issues there?

And finally, we talked, although we spoke -- we spent actually much less time on the question of recording and retaining information for pre-screened solicitations, and spent actually a good amount of time just talking about who does it affect? Are we trying to get at the credit companies here? Do we already have ample regulatory capacity through FCRA for that, et cetera, et cetera, and we'll come back. So what I'd like to do is start with the issue, because I thought it was so much fun, the issue of the definition of creditor. And maybe, Les, why don't you, because I think you sort of had one viewpoint which I think is really an important one to kind of set this off. Why don't you give us your perspective on what you think is useful or not useful about the proposed on that.

MR. FIRSTENBERGER: Sure. Thanks, Jeremy. ECOA and Reg B are fairly clear, well-defined, and a lot of people operate under those given rules. The concern, I think, that a lot in industry have is that the proposed additions and additions to the commentary will create some significant uncertainty that has some unintended consequences. Now in talking to Fed Staff, the idea here is not to regulate the secondary market, not to create an additional burden for, you know, securitizers, Freddie, Fannie, and others to be deemed a creditor under this new proposal. But as written, there's certainly the potential for that, so I think there has to be a step back, and FED Staff certainly take a hard look at the wording, and what they're talking about here, and what is the potential implication for making what appears to be an additional duty.

If the intent here is not to create an additional duty, and it's simply a clarification of the state of the law as it is, so be it. I don't think there's an issue there. If we're talking about additional duties, they're going to be imposed on lenders. They can go up the food chain to securitizers and aggregators. I think, again, the consequences of what the rating agencies are to consider this new additional risk, how you're going to quantify that risk, what credit enhancers are going to do in the secondary market transactions. If that's to occur, I think that is significant and should be contemplated prior to action, and so I would ask that you look at those issues.

MR. NOWAK: Elizabeth, would you like to chime in here?

MS. RENUART: My response to that, Lester, is that the -- as you, yourself just said, the definition of a creditor and an arranger is already clear under the statute and Reg B. What the commentary does is not to expand that definition, but to merely give examples of what might constitute a creditor or arranger, and so it's not intended from my reading of it, to create more liability further up the food chain, but to simply give some suggestions as to what situations might constitute a creditor or an arranger under the definitions that already exist in the law. And so for the secondary market, I think it has nothing to fear by this mere clarification, because it's carefully crafted to say who regularly participate in making credit decisions, including citing the terms.

Fannie and Freddie do not regularly -- are in the process or in the business of making the credit decision itself about whether a particular borrower is in or not in. They set the standards for it, but they aren't making the absolute decision about someone who is being rejected or accepted. They are not --

MR. FIRSTENBERGER: As long as we agree on that point, that they're not --

that isn't deemed a credit decision, that you know, the use of DU is not a, you know, deemed a creditor under this, we agree.

MR. NOWAK: Les, you used yesterday the example of the large mortgage lender that uses 6,000 brokers around the country.

MR. FIRSTENBERGER: Correct.

MR. NOWAK: Why don't you play out what you think the potential liability of burdensome issues might be there.

MR. FIRSTENBERGER: A second issue unrelated to the large aggregators is a potential for a competitive advantage or disadvantage, depending on your viewpoint, for individuals who access their distribution to a product to consumers via brokers. If a large broker network of, you know, I just used a number of 6,000. You know, pick a player like WAMU, or somebody like that, that uses a large broker network, if they have an additional duty imposed upon them to do Fair Lending testing on every broker, you know, the system grinds to a halt, and as opposed to a lender that simply originates on their own. It's much easier for them to do self-testing on their own, so I think you need to understand the burden you would be asking here if you are saying that additional duty is being imposed.

MR. NOWAK: Teresa, your perspective on this?

MS. BRYCE: I think one of the things that concerns me, and this reminds me of some of the arguments that came up in the Long Beach case by the Justice Department, is that it's one thing when you're talking about the lender actually underwriting the loan, and it being involved in the decision on whether the loan is granted or not.

Where I have a concern is when it comes into the pricing area, because typically with respect to pricing, the lender is not -- is saying I will maybe buy a loan in the prime market. A lot of lenders have gone to saying I won't, you know, allow you to earn more than this, Mr. Broker, but they're not able to, at the time a loan is locked or a loan is made, to identify whether there is any Fair Lending pricing issue on a real time basis with the rest of the portfolio of loans. And so, what that means is that it would require lenders to monitor after the fact what has happened. Loans have already been sold in the secondary market, so that's an issue in terms of whether you can even make an adjustment after the fact.

The other problem is that most brokers do do business with a number of lenders, so you may not have enough loans from a particular broker to have a statistical sample that meets any requirement statistically to look at that. You also may have an issue where there are no issues with the loans they've given you, but if you looked at their loans across the board, they have an issue, or maybe they don't.

The other thing I would say is that if it's going to be looked at in terms of the aggregate data, that a lender has from various brokers, and this is one of the things that has happened on the retail side as well as the broker's side. Then you may have a situation where there's no discrimination by any individual broker, but the data when aggregated makes the appearance that there's been discrimination, and a good example is that you may do business with a minority broker, in a minority community. They may be pricing, not discriminating in their practices, but when it gets aggregated into the other data, that becomes a problem. The lender's option is to stop doing business with that broker, but I have to raise the question as to whether or not you want the lender walking away from that community, if that's the outlet they have to do business there.

MR. NOWAK: All right. Before I turn it over to Connie, I just want to remind you that what we're dealing with, of course, here is not, and you know, is not just brokers, which has got some regulatory apparatus, although in many states I think not enough. But we're dealing with a proliferation of new arrangers from contractors to the home improvement industry, I mean on down the line. They've really become the arrangers in their city credit in many ways, and so this is -- I think there was some agreement that this is a proliferation of new arrangers that are -- that we're -- that create a new problem for us, and the question is how do we get at that problem? Connie.

MS. CHAMBERLIN: Well, I think everybody recognizes the difficulties for lenders in dealing with some of these issues, and from a practical standpoint. But I think that any time you use somebody, any time you have a business relationship with someone who is providing a service for you, as the arrangers are, there is a responsibility both to do some due diligence, and who you're dealing with. Are you simply going to deal with anybody who comes in from the street? And also, to set some clear standards.

This is the kind of thing that we are interested in. We are not interested in this kind of thing. If we see that you are involved in this kind of activity, we will take whatever action, you know, is available to us to take. And there's been a lot of talk, understandably, about reputational issues for lenders. And I think that we overlook sometimes the reputational damage that can be done by a broker who is violating some of the Fair Lending laws, if in fact that broker is selling a lot of loans to a particular lender. If he is found out, it's going to tar the lender, so I think everybody has an interest in trying to find ways, however difficult that may be, to create some kind of incentive for both the lender and the person providing the service.

MR. NOWAK: Les, and then Elizabeth.

MR. FIRSTENBERGER: Broker, and again it's not only the broker context, but in the broker context we're talking about an entity that's typically licensed by the state, so there's a presumption that a fair amount of diligence has gone on, and the free flow of commerce says hey, I can rely upon that. You know, in certain circumstances, additional due diligence is required, but I think there's a real problem in fractured distribution systems to put that burden and what we're talking about here is shifting a regulatory burden or an examination burden to the industry, and that's -- you know, that cost is significant, and unquantified right now. But you can bet your bottom dollar it's going to get passed on to the consumer, because it's -- it is.

MR. NOWAK: The freeze fracture distribution system though is what we're talking about, and the question is what are the points, or what is the system of regulatory accountability in a distribution system that's increasingly fractured.

MR. FIRSTENBERGER: Right. Unfortunately, the FTC has the gaps or is where the gap is right now. The Federal regulating institutions all have very competent regulators. State licensed institutions have state examiners, and under the federal regulatory scheme, the FTC has primary oversight, and for whatever reason, Congress or the FTC aren't as near as vigorous as the banking regulators.

MR. NOWAK: Elizabeth, and then Buzz, and then Tom. I think you had a point too.

MS. RENUART: I think again to put this whole discussion in perspective, all of the concerns that you've expressed, whether I agree with them or not, are concerns with the current state of the law under the ECOA and Reg B. And what the Staff has proposed is not to change that state of the law at all, but simply clarify some situations which for once I dispute with Jeremy, I don't think these are new arrangers that have just suddenly appeared on the market. Home improvement contractors as bird dogs for lenders, mortgage brokers as bird dogs for lenders, car dealers as bird dogs for lenders have been around for a long time. It's just, I think, catching up into our consciousness that oh, my goodness, there's some ECOA implications here. And they've been spawned by the lawsuits that have been filed against the car financing arms of certain car manufacturers, who have dealt with dealers, and have been involved with discriminatory, or at least alleged discriminatory price markups beyond what the product is already priced for a legitimate risk. And so, now it's become -- you know, it's come into our consciousness, but that's the state of the law prior to the Staff proposing to change the definition, which they are, but proposing to give illustrative examples of what an arranger or a creditor might be. And that lenders that I have talked to said they already do due diligence with their brokers, because there's a wide variety of other kinds of claims that could be raised against a lender based on the crazy behavior of a broker out there running amuck. And so, this does not place any additional duty on anyone to go out and do more of a check, than you would otherwise, to make sure that this person is a person you want to do business with.

MR. NOWAK: Buzz and then Tom.

MR. ROBERTS: I have a concern about keeping the playing field level. And if you have one institution that does its own lending, and another institution that works mostly through brokers, how do we keep the playing field level so that the direct lender isn't disadvantaged in comparison with a competitor that works for brokers?

MR. NOWAK: Tom.

MR. FITZGIBBON: I just wanted to point out I guess the -- what has happened over the last probably 10 years is that the migration to this transaction type of environment with brokers as the major delivery channel for mortgage product is that frankly it was driven by efficiencies to a certain degree, that regulated financial institutions found themselves in a position where the cost to originate a loan was so ungodly high that they wanted to migrate to a less costly system, and that was the reliance on the brokers and correspondent relationships.

However, what I think has happened is that the, you know, the move towards this channel has -- for the efficiencies has really gotten ahead of the regulations. I mean, the fact is that if the banks manage compliance based on risk, and they look at their volume of lending activity, and they see that they have a master broker in Pueblo, Colorado who has 95 independent brokers working through them, is producing 60 percent of their product, they damned well better be making some due diligence visits to ensure two things. One of the things is what we don't see, or what the industry doesn't see are loans that don't get made. That's my concern, what loans don't get made, and why aren't they getting made, because we don't see that. We only see, the ones that work in this channel only see the loans that get closed. They don't see the ones that get turned down. And that's a major concern, frankly, is where discouragement of the market place takes place at a level where the investor/lender is not present.

MR. NOWAK: Teresa and then Pat.

MS. BRYCE: I think the comment that lenders should monitor brokers is true. I think most lenders have been monitoring brokers for a number of reasons. They monitor for flipping because of the economic issues related to that. They monitor because of fraud, potential fraud issues.

MR. NOWAK: Right.

MS. BRYCE: So there's always been that issue. One of the interesting problems has been that, you know, I've worked with lenders before where we've kicked brokers out of the programs because of those types of issues. And then there may have been one or two particular employees of that broker that we identified as being the culprit. And the next thing we know, someone else has hired that person. We can't tell the new employer, for obvious legal reasons, about what we ascertained, but now we have to cut off that broker because they've now hired someone that was suspect, and we can't keep track of all of those movements. So part of the issue is a timing issue because my concern is being responsible for a particular loan at a particular time, versus whether or not I monitor and I find something out later, and then cut the broker off. But if I find something later, am I responsible for everything that went before that, when there was no reason for me to know that there was a problem?

MR. NOWAK: Pat.

MS. McCOY: A couple of points. One is that in our market economy, we very much have the notion of discipline by market actors with respect to market actors, so I don't think we're asking market actors to take on some new governmental responsibility. This is traditional to our system. And in doing so, we can support good lenders, such as those that Teresa speaks of, who are trying to do the right thing, but are facing an uphill competitive battle.

I'm also sensitive to some of Teresa's concerns in terms of the timing issues and due diligence. And in what we would expect of, for instance, a lender with a force of brokers, you might think of several things. First of all, you want written contractual expectations as to their Fair Lending responsibilities. You probably need to do some training because just putting in a sentence is not enough to inform the brokers as to what they need to do.

Subsequently, if there is a red flag presented by a loan, that needs to be investigated. And finally, if there is a problem with discrimination, there needs to be some sort of financial teeth, a penalty. You fire the broker, you turn back the loan, you get a refund of the broker's fee. But we can think very creatively about exactly what we expect the oversight responsibilities to be.

MR. NOWAK: Are there additional comments? Yes, Les.

MR. FIRSTENBERGER: I guess I don't necessarily disagree with, or agree with what you were saying, that it's necessarily the duty in our system for market participants to be subject to third party liability for the actions of others. There usually has to be some kind of privity of contract or agency relationship to impute that liability. And what this does here, I agree the state of the law is, you know, if you have -- there's a reasonable notice standard, that you have a duty to do further inquiry. And again, my only point is, if Elizabeth is correct, and this is not trying to impose any additional duties, that's great. If it is trying to change the state of the law, you know, you're messing with a whole bunch of different market forces here that should really be understood prior to going forward with that.

MR. NOWAK: Yeah, Tom.

MR. FITZGIBBON: Just one other comment. I think maybe following up on what Lester says is that, you know, if this change is only going to impact regulated depository institutions, then I've got a problem with it, because the impact here on SEC regulated mortgage backed securities, wholesalers certainly also has to be as important terms of their own due diligence, and the rating agencies and others, perhaps, that have to be doing that as well, so I think there's a larger picture here than just the regulated depository institutions.

MR. NOWAK: Does anybody from the Fed want to comment on that, just a point of clarification?

MS. RENUART: I'm not from the Fed, but Reg B applies to all creditors and all lenders with some exceptions, so we're talking about a much larger pool of players here than just the regulated banks.

One response to what Lester said about our system not self-regulating itself, our doesn't necessarily agree that that's what our system is. For regulated -- for financial institutions, the OCC has come out with a fairly detailed plan, not only for national banks doing prime lending, but then there's a separate one on sub-prime lending. And it's a set of instructions on how those regulated entities ought to be looking at third party arrangements. And there's fairly complicated procedures that you have to go through to set a plan in place, and a way to monitor that plan for dealing with these third parties, which could include mortgage brokers, which would include payday lenders you're trying to operate with in another state. But whoever those third parties are, and it doesn't limit it to a definition of third parties, there is a very detailed internal process, so in the industry there is now a very due diligence standard that's been created by federal agencies.

MR. NOWAK: Les, if it's okay with you, unless it's a very brief comment, I'd like to move to the prohibition on data notation.

MR. FIRSTENBERGER: Just comment, I --

MS. RENUART: You agree with me, Les. Is that what you're going to say?

MR. FIRSTENBERGER: The last comment is I agree with you, comma, but, however. I agree with you there's a regulatory process in place. There's enforcement structure in place, but my concern here is Lehman Brothers, First Boston, Freddie, Fannie aren't contemplating being hailed into court under the statute, and I think that's the dynamic that, you know, I'm trying to address.

CHAIRPERSON BROADMAN: Jeremy, if I could just --

MR. FIRSTENBERGER: On record.

CHAIRPERSON BROADMAN: -- briefly interrupt. I'd like to recognize that we've been joined by Governor Olson. Thank you for joining us, and welcome.

GOVERNOR OLSON: Thank you.

MR. NOWAK: I'd like to move now to the conversation about removing the prohibition on data notation for non-mortgage credit data, about race, ethnicity and gender. And also, whether voluntary notation would qualify for the self-test. That was sort of a sub-issue here.

And again, we had a robust conversation yesterday, should this all be left alone? We're always reminded by the Fed Staff that, you know, one option is just to leave things as it is. Should -- is the voluntary -- is lifting it on a voluntary basis useful? If it is, why? If it is not, why not? Or should it be made mandatory, and then there was this broader question about what kinds of products, or are there particular kinds of products, or particular type of lenders that we're trying to get this information for?

So let me begin. Actually, Les, I would like to begin with you on this again, if you don't mind. Tell us your perspective from the particular industry that you've got.

MR. FIRSTENBERGER: Okay. Well, you know, I think of this as the Hippocratic Oath. First, we should do no harm. The voluntary -- there's two schools of thought here, the voluntary collection of race, gender and ethnicity data on non-mortgage products. Consumers groups said hey, it's voluntary. No harm, no foul. They can do it if they want. Industry says well, you know, is it really voluntary.

Dorothy made a very good point that sure, it's "voluntary", but in any large bank merger, it's going to be used as a protest or device in a protest that it won't necessarily be as voluntary as you think.

The second item is for those -- and so the question from industry was what creditor in their right mind is going to voluntarily do this, absent a self-privilege test, or a privilege self-test. And there's very few that would, I think anyway.

Right now you have the ability with your collection of this data on HMDA mortgage loans to be able to do self-tests, to determine whether or not you have issues or problems with your Fair Lending programs. If you don't have that same privilege here, there's a very real concern that, you know -- well, very few people or creditors are going to take that risk absent that privilege, because you expose yourself to additional liability, and question mark what is the benefit.

MR. NOWAK: Connie, from where you sit, you've got a different perspective on this. Is that right?

MS. CHAMBERLIN: Yeah, I really do. I think that -- although, yeah, maybe there's a common ground here. I'm not sure that I think voluntary is a good idea either. And I think that, and I know that Governor Gramlich disagrees with me here, that --

GOVERNOR GRAMLICH: I only ask questions at these meetings.

MS. CHAMBERLIN: I think that for it to make sense, it really does need to be mandatory. It's the kind of data that should be collected by everybody. It really doesn't make any sense to have only a part of the industry collecting the data. I think Dorothy is absolutely right. There will be pressure on some, and we need data transparency. The lending process, the more data we have, the more we will understand what's going on in the process. And I think that from a public good standpoint, it's hard to argue for less data.

MR. NOWAK: There was some question in our conversation yesterday about whether there were particular products, small business loans, car loans or other particular products where there have been some history, or some perception around discriminatory dynamics, other particular (inaudible) where this would be more or less useful, because I want to make sure we get to that. But, Earl, you had a comment here?

MR. JAROLIMEK: Yeah, and I -- we've talked a lot about the data collection problems. I'm not going to restate those, but I think there was some comments made yesterday that, you know, banks have been asking for this to be voluntary. And I think if that is the case, which I don't dispute, it's got to be a very, very small minority. I've talked to several bankers that I network with routinely, and there just really is no grounds for this, at least from an industry perspective, quite the contrary, so I want to just remove that as a possibility.

The other thing is, it's interesting that --

MR. NOWAK: But they're not asking for it to be mandatory.

MR. JAROLIMEK: They're certainly not asking for it to be --

MR. NOWAK: So I want to make sure -- no, I didn't mean that as -- I usually mean most things as a joke, but I did not mean that as -- so then the other option is to maintain the prohibition.

MR. JAROLIMEK: Leave it as it is.

MR. NOWAK: Leave it as it is. Okay.

MR. JAROLIMEK: Yeah. I think that's clearly the position of the industry at this point.

The other interesting thing is this is the third time we're revisiting this subject, and I guess I would just look back at what prompted the leave it alone decision in the past, only to say that I don't know that anything has really changed to make that decision a bad decision. And I would just encourage those reasons why the decision was made to be revisited, and renewed.

MR. NOWAK: Dorothy.

CHAIRPERSON BROADMAN: I think the question is what's the goal? What is the purpose of having voluntary collection. And as Connie and others have already articulated, if it's to get information into the public, this is not going to work, because there will be no standards for how this data is collected, and who's going to collect it. And I don't -- I didn't hear anybody say that this would be really useful as voluntary.

The other possible goal is to create an opportunity, or maybe even encourage industry to have an opportunity to self-monitor. And if that's the goal, then we need the self-test privilege. I don't know if that's something that the Board can go back and take a look at, but if it is, I think that's worth doing.

The other thing I would say is that if the Board decides to pursue this, I would suggest that it go out for public comment, because the last time public comment was taken is years ago, and I think that people need to have an opportunity from today's perspective to comment on this.

MR. NOWAK: Ron.

VICE CHAIRPERSON REITER: I just wanted to make a comment about the idea of a privilege. The privilege undermines, if not destroys, the public accountability, sort of this information. We want to, of course, all the lenders to behave properly, but we need to know, we need to have that information accessible, and privilege destroys that. Privilege, of course, undermines the ability of regulators at every level to try to address the problem.

It should be remembered that in most states, there are state anti-discrimination laws that have provisions that are very similar to the ECOA, and the idea of creating a privilege here will wall off state regulators from protecting their own citizens against discrimination.

MR. NOWAK: And you believe if it was voluntary -- let me just sort of ask the question, because I think, Dorothy, what you said was that we don't want to fall into the trap of bad data versus no -- we're better off with no data versus bad data. That's not the kindest way to put what you said, but if it's just voluntary. Is that -- do you believe -- is that your sense, Ron? What is your -- if it's voluntary, as proposed?

VICE CHAIRPERSON REITER: Well --

MR. NOWAK: Would that give us bad data?

VICE CHAIRPERSON REITER: I don't think it necessarily produces bad data at all. I would probably be more of an advocate of a mandatory rule. But I think whatever the rule is, there needs to be an openness and transparency, and that we can't wall off this information entirely, but I -- by privilege, all kinds of bad things lurk behind the walls created by privilege, and I don't think we can establish one here.

MR. NOWAK: Yeah, Tom.

MR. FITZGIBBON: The wall of self-test, if you will, confidentiality does not permit the institution to continue a practice that is considered to be discriminatory in nature. They must take immediate corrective action if they find something, so I think that the issue here is whether -- am I correct in that assumption? That's my --

VICE CHAIRPERSON REITER: You're correct, and the privilege is lost if they don't.

MR. FITZGIBBON: That's correct. Your claim of privilege is lost if you do not take immediate corrective action, so I think the issue here is do you crawl, before you walk, before you run? Are you going to allow the institutions, perhaps, to develop a over time through self-test, some standards that then we, as people who are concerned about making sure that discrimination doesn't continue, that we've got some standards in the future that we could benchmark.

MR. NOWAK: Let me go to Hubert, and then I'll come back to you, Ron. Hubert, and then Teresa, and then Ron.

MR. VAN TOL: I think one of the problems with setting regulations is that all the right questions don't necessarily get asked immediately, and having a voluntary period I think would allow us to look at that, see what, you know, how a mandatory requirement should be structured, because I think it does need to be mandatory. I don't quite understand the industry fear that data gets misused and misrepresented. You can't misuse data unless there's at least a kernel of truth, so I mean, I think every time industry gets beat up because of discrimination in lending, there's usually something there that has given reason for that. And with auto lending, and small business lending, I think the tales that people are hearing out there is that we certainly have reason to be concerned about those, so if this is the baby step we have to take to learn how to do it properly, I think it's a good baby step.

MR. NOWAK: Teresa.

MS. BRYCE: I had raised the issue about whether or not this needed to be all non-mortgage creditor, whether or not it should be product specific. And, Hubert, you raised auto lending, which is one of the ones that I had raised yesterday as being something that typically is done in person, and so there may be a better reason for why it should be collected in the auto lending situation. But in the credit card situation where many credit cards are done through mail solicitations, or maybe over the telephone, it just didn't seem to me that it was necessary to ask for that data in a credit card situation. And that, in fact, for lenders who were predators, it may give them information that we otherwise wouldn't want them to have, so it just seems to me that we ought to think about where it's needed, and not just take an overall approach.

MR. NOWAK: Governor.

GOVERNOR GRAMLICH: Just on that point, is it the -- I know you've talked about this a lot, but is it the sense of the group that were this regulation to be changed, that it ought to be changed on some types of credit, and not other types of credit? I mean, is that the sense of the group? And if so, why?

MR. NOWAK: Some products versus other products, is that --

GOVERNOR GRAMLICH: Yeah.

MR. NOWAK: I don't think -- I mean, I don't think we had a consensus on that. There was not enough conversation about it. I mean, there was some -- there were a few intriguing ideas set out. For example, that there is some evidence that there's some good data around, and a few cases around auto loans that might be a place to start, make that mandatory and gain an understanding. But I don't think we had any consensus around that.

MS. BRYCE: Right. I think the other interesting issue too is that with respect to auto loans and credit cards, for instance, I think there was a view that those typically are not being denied. It's usually the pricing --

MR. NOWAK: The pricing, which is the issue.

MS. BRYCE: -- of how those are being priced. And so frankly, in collecting that data what would be helpful then is to look at the pricing analysis to see if there's an issue, and without the self-testing privilege that may pose a problem for an institution to actually get to the root of what may be happening.

MR. NOWAK: I'm sorry. Ron.

VICE CHAIRPERSON REITER: I just wanted to follow up. It seems to me that the problem with the self-test privilege is that there may be corrective steps that can be taken, but it's a way of kind of laundering past bad practices, and if the practice is resumed, well it may be once again revealed by another self-test. And then that self-test creates the immunity, in effect, for the prior bad conduct. Occasionally, bad conduct needs to be redressed in other ways. It may need to be redressed formally. Maybe the victims need to be compensated. Injunctive relief might be appropriate in bad cases, and if you create a complete information black hole, in effect, you prevent anyone from ferreting out repetitive bad practices.

MR. NOWAK: Russ.

MR. SCHRADER: Whenever somebody says credit cards, I feel, you know, eyes turn in my direction, so I guess I -- Teresa's point is well taken, especially if you overlay it with the point that we made earlier in the mortgage context, when we were talking about how do you get this data? And, you know, talking about how Native Americans are not necessarily recognizable if they decline to answer the question, you know. And how people explaining on the phone to put it in a favorable light, to ask people to answer the questions, as opposed to reading the disclosure on the bottom of the mortgage saying oh, it's required by government. And obviously, can't even start with that if it's a voluntary standpoint, so I think that you're going to run into significant data quality issues in a situation like the credit cards where they're virtually never opened face to face, where you don't have that backup, make your best guess thing, where it's opened by telephone, by mail, by Internet or anything except face to face.

Two other observations about the nature of the product. One is, you can definitely see it in a mortgage context where it's a huge cost. It's a massive expense. It's probably the largest loan an individual will ever take in his or her life. And if there's a pricing differential, it's enormous over the term of the loan.

In a credit card standpoint, the cost is, shall we say, significantly less. The other thing is what is the cost of switching? If you think that you've gotten a bad deal, in the mortgage context you're talking about a point or two, you know, a couple of thousand dollars, a long period of time, a huge paper trail, recording deeds, getting releases and so on. The cost of switching a credit card is sort of opening up your mail that day or picking up the telephone during dinner, so I think that there are qualitative differences, you know, among the different products that would first give you bad data, if you got appropriate data. And then also, there are qualitative reasons as to why you might consider anything on a case by case, or product by product basis.

MR. NOWAK: Les.

MR. FIRSTENBERGER: Just speaking quickly to Ron's point, and I think you inadvertently misspoke. You stated that immunity would attach to that. Immunity doesn't attach to those actions for a lender. He would still be liable. It's just he has -- that information cannot be used against him in court.

VICE CHAIRPERSON REITER: Well, exactly. I mean, you can't discover the information, and you can't bring an action. And it --

MR. FIRSTENBERGER: There's other ways to prove liability. I mean, it's not the only way.

MR. FITZGIBBON: I just want to follow up on that too, if I can. And that's --

the fact is that if you discover something in the self-test, you take prompt corrective action. You have to notify your regulator. If you're making changes, for instance, on Truth In Lending Disclosures, or you're providing compensation for incorrect information that you provided on the APR. And if you continue that practice, I mean, I can tell you, you come back and the next exam cycle is a continuation of a pattern and practice of violating the regulations, you're not going to get by with that in terms of Fair Lending examination.

MR. NOWAK: Dorothy.

CHAIRPERSON BROADMAN: Yes, thank you. The question that we're facing is should this be voluntary.

MR. NOWAK: Right.

CHAIRPERSON BROADMAN: It's not should it be mandatory. And so within that context, in terms of -- I think Russ makes a good point. Really the likelihood of any institution doing this is very slim, because it creates a competitive disadvantage. People are offended by these questions, and if you can't say I have to do this. The federal government is telling me to do this, they're not going to because they'll probably walk down the street and go to a bank that doesn't ask these offensive questions. But if what the Board is trying to achieve, and I think it's clear the public data is not going to be very useful under a voluntary program. If the Fed is trying to achieve a form where we bankers can monitor ourselves, and I'm feeling very discouraged because I'm getting the sense there is no level of confidence that if we have this data, we actually will use it appropriately. But I can tell you, that's not true in all institutions. Some institutions do take this very seriously, and there may be a value to having this data, but we won't collect it without a self-test privilege. There's just too much risk involved in that.

MR. NOWAK: Any other comments on this? Ruhi, you've been out data consumer person.

MS. MAKER: Yeah. I guess, I'm sort of leaning towards where Hubert is. I mean, I want it to be mandatory. I mean, I would be happy to have small business and auto loan. I mean, I think -- I mean, one of the things that I'm starting to recognize with all these people who end up in sub-prime loans, they started off with a lousy auto loan. That got them on a slippery slope and wrecked their credit. And, you know, then you go back to even payday lending. It's like the deeper you dig, you know, you have to start correcting. You can't just correct the mortgage market, and I've certainly started to realize that so -- but I would certainly say, you know, if banks are saying hey, we want to collect it, and I take Dorothy's point about saying we will force the collect it. I don't know. I mean, how -- we community groups seem to be awful powerful sometimes when --

MR. NOWAK: We hope.

MS. MAKER: I wish I could meet some of these very powerful community groups, but I would say start with voluntary. And, you know, if we can't get agreement, I mean, that would exclude credit card, that would be where I would go. But I would say go with small business, where we know. I mean, we know with auto rental that there are some problems out there.

MR. NOWAK: Frank, and then Elizabeth.

CHAIRPERSON BROADMAN: Jeremy, I think Dolores has a comment.

MR. NOWAK: Oh, I'm sorry. Dolores.

MS. SMITH: I have a question. If you were to -- if a way were to be found to apply the self-privilege test to collection of these data, might you conceive of limitations on the use of the data? Would you have the data available both for -- I mean, primarily or exclusively for the self-test; that is, auditing to see what your performance is. Or would you still be able to use it for marketing purposes and that type of thing?

MR. NOWAK: Anybody from the industry's perspective want to answer that?

CHAIRPERSON BROADMAN: Well, let me -- when you say marketing, are you -- what are you envisioning there?

MS. SMITH: I'm just -- my question is would you limit it -- if the privilege applies because it is self-testing, would you limit the use of the data to that purpose?

MR. NOWAK: Tom.

MR. FITZGIBBON: You know, like any other kind of research that you do on your customer base, we do it all the time. The CIF, customer information files, and by proxy we're looking at our depositors, and our borrowers, and all the rest to see, to find more people who, in effect, "have the same kind of profitability or profit potential", if you will, as the ones we already have. And certainly, it would be helpful for us to understand that market better in terms of the channels, how we got that customer in the first place, and the design of the product to see if that was much more attractive than our competitor, that sort of thing. So I would say, you know, if we were able to do it under a self-test privilege, certainly I think we would use it to try to understand the market better. I don't think we'd use it for -- I know we wouldn't for direct mail. We wouldn't use it for targeted types of transactions, but it certainly would be helpful to us to get us to understand the market better.

MR. FIRSTENBERGER: It probably would be used in modeling, marketing modeling.

MR. FITZGIBBON: Well, it could. It certainly could very well be. Yeah.

MR. TORRES: And I'm glad you asked that question, because that's where I was headed. There's an awful lot of information about customers that float around amongst institutions in the credit card industry, and other industries, as well, and so I wonder -- you know, they may not have exactly the information that is being sought, and it may not be obtainable because the application is done through the mail or over the phone, but there's an awful lot of information out there, and I wonder if that's not a way to maybe get at some of this information.

MR. NOWAK: Earl, and then Elizabeth.

MR. JAROLIMEK: Right. I just want to tie a few previous comments together. I think with the self-test privilege or not, under a voluntary basis, I don't think it's going to offer comparables that will make the use of the data very valuable to the industry, and anyone for that matter. And I guess there is a strong concern that voluntary will quickly become mandatory. And I think that's got legitimacy behind it, so I think once you open the flood gates with a voluntary standard, mandatory will quickly follow.

MR. NOWAK: Elizabeth.

MS. RENUART: I'm wondering whether, and I'm certainly a person who thinks there ought to be Sunshine, that information ought to be available to the public. But I'm wondering whether in between the self-test privilege which seems very strict to me, and complete availability to the public, whether there's some other way that this information, if voluntarily collected, could be at least seen by the regulators, because one can -- one thing we heard yesterday from Adrienne Hurt was that the Fed might be interested in seeing what this data was revealing, however imperfect, or however incomplete it might be, to then decide whether it was worth imposing a mandatory obligation. And if they can't ever see it, then they can't make that decision, and so maybe there's a middle ground here, at least, on how the data would be used if voluntarily collected that might make sense.

MS. McCOY: Jeremy.

MR. NOWAK: Yeah, Pat.

MS. McCOY: Thank you. I think another issue would be the ability of the institution to share that information within the holding company, and customers who did not opt out, the ability to sell that information for certain purposes. I assume that the normal Gramm-Leach [Gramm-Leach-Bliley Act] default rules would apply to that information unless we address that point.

MR. NOWAK: Ken.

MR. BORDERLON: And I wasn't in part of the discussion in the Committee, but from the credit union world, I would say, you know, we just finished a discussion on HMDA with the telephone and electronic data notification, and I would disagree a little bit with some of the previous comments about product driven. Most of our loans in the credit union world, auto or personal, are either telephone or now electronic. And would, in fact, be impeding that, so you know, from our perspective I'd just leave that as it is.

MR. NOWAK: Are there any other comments on this? If not, we'll go to the final part of our conversation, which has to do with record retention for pre-screened solicitations. Under this proposal, creditors would retain records for pre-screened solicitations that were defined as firm offers of credit. They would retain that information about the criteria used to select potential customers for a 25 month retention period. Is that right, it's a 25 month retention period? And the -- this would, of course -- Russ, this is, of course, is a credit union, a credit card issue, might be for increasing numbers of small business, credit scoring loans, it may capture some of the credit scoring factories out there right now for small business lending. So let me just open it up for comments, issues, concerns on this. Everybody is at the end of their day.

MS. SMITH: Jeremy, we'd like --

MR. NOWAK: Yeah, Oscar.

MS. SMITH: We'd like to remind people about what it is that they would be required to keep for the 25 months.

MR. NOWAK: Go ahead.

MS. SMITH: Okay. Basically, under the -- this is for pre-screened solicitations where there is a firm offer of credit made to individuals who meet the criteria that the financial institution specifies to the credit bureau. This is, you know, where the credit bureau is doing the identification of the people. And under the Board's proposal, a lender would be required, or a solicitor, a lending institution soliciting customers would be required to keep for the 25 month period the criteria that were articulated to the credit bureau, in terms of what are the criteria that the institution asked the credit bureau to identify people, if they meet them, so that's one thing.

The second thing would be the lending institution would be required to keep the part of the marketing plan, assuming that this solicitation is part of a marketing plan, the part that related to the pre-screened solicitation offers.

The third thing would be any complaints that might be received with respect to the pre-screened solicitations, so that is the -- again, this is because under Regulation B, the provisions of the ECOA and Regulation B apply to applicants and not to people who have not applied for credit.

We believe, however, that in the case of pre-screened solicitations, because a firm offer of credit is being made, in effect, there are applicants that are involved in these transactions.

MR. NOWAK: This has to do with the retention again of information, and not public disclosure of information.

MS. SMITH: Retention of information that the agencies would look at to determine whether there is a problem in this area, as some people have suggested, or not.

MR. NOWAK: Oscar.

MR. MARQUIS: Well, under the Fair Credit Reporting Act, the criteria has to be kept for three years already anyway, so the addition would be the marketing pieces, the marketing plan to the extent there is one, and complaints. And I'm not sure what you get from that, what the purpose would be in keeping marketing plans. It's a very complex problem. I think I'll let Russ or someone else address that. To the extent there are marketing plans, they're very complex. They change constantly based on the names and the criteria, and credit availability, and whatever. But if you had the marketing plan and complaints, I don't know what that would show regarding discrimination, or Reg B.

MR. NOWAK: Well, it could show some things. Russ, did you want to chime in here or no?

MR. SCHRADER: Actually, I was interested in hearing what was the gist of the conversation for the people who were there, and then I'll respond to it.

MR. NOWAK: Pat.

MS. McCOY: To answer Oscar, one of the concerns is that there has been targeted according to prohibited grounds in credit card solicitations, and I can name a couple of instances in my local community. Affinity cards that are marketed based on what ethnic identities. I received the Irish identity card on solicitation, and many black residents received something similar. A marketing plan will identify that.

The other thing I'd like to say is that the burden here is very minimal. This is a do not destroy rule. It requires no new creation of data.

MR. NOWAK: Les.

MR. FIRSTENBERGER: What would the violation be there? You know, credit is not being denied.

MR. JAROLIMEK: Yeah, that was my point.

MS. McCOY: What's the violation?

MR. FIRSTENBERGER: What's the violation?

MS. McCOY: The violation is if there is risk base pricing. So for example, I mean a local press story looked at the card that was marketed to black Clevelanders, and the card marketed to white Clevelanders by the same company, and the APRs for blacks were significantly higher.

MR. NOWAK: Was it pre-approved?

MS. SMITH: I should add --

MR. NOWAK: Go ahead. I'm sorry.

MS. SMITH: I should add here that there is -- there would be under this proposal no citing of a violation, because there is -- as long as Regulation B does not apply to pre-screened solicitations, then there is nothing to cite the institution for. At this point, we would be -- we would basically be creating information that could be looked at to determine whether Regulation B should be changed.

MR. NOWAK: I think, you know, Les, the question has become less one. I think it's been characteristic over the last couple of years of conversations here. It's actually been less one of denials, sort of a paradigm shift that's moved from denials to one of everyone gets credit, but what's the pricing, and what's the nature of the affirmative or negative marketing for different segments. I think that's been really a big part of the changed conversation.

MS. MAKER: Yeah, I mean, I would echo that. I mean, you know, it's very simple. The prime arm sends to the white suburbs, and the sub-prime affiliate sends to the inner city minority communities. I mean, I think, you know, it's -- there's a lot of anecdotal evidence to that effect. And, in fact, in New York, I don't want to go into any of the details, but there were some very interesting things happened after regulatory agency issued and asked this particular lender to do some affirmative marketing, and a lot of -- based on some data analysis we had done, and some very interesting things occurred when the lender, when they discovered how they were being -- how that -- how they had asked the lender to comply was, in fact, being complied with. They then issued an order and they said you couldn't do it this way, and then all of that information then had to be public. I mean, it's an interesting story but, you know, we see -- certainly see, and we would be very interested. So, for example, we would be able to go back, and we would be able to say -- everyone is saying, we would be able to go to the Fed and say everyone is saying all the material that's coming to this neighborhood is from, you know, affiliate, and what's coming in this neighborhood is from the prime. And can you look and see whether it's a deliberate targeting going on. And, of course, it's an interest rate differential, absolutely.

MR. NOWAK: More comments here? We have only a few more minutes of our time.

MR. SCHRADER: Well, I thought you were talk -- I guess, I'm not familiar with the particulars there, but earlier today you were a great proponent of risk base pricing, and I would presume that they thought this was something similar to it.

MS. MAKER: no.

MR. SCHRADER: I don't know. But I guess, you know, going to the point, I think people are very concerned about the burden. And there is an extra burden because as marketing becomes more and more sophisticated, you know, they're cutting these targets finer and finer in terms of, you know, the marketing jargon of a segment of one, to try to find the single offer that will make you say yes. And they are coming up with so many different marketing plans, and so many different ways of slicing and dicing data, and monitoring responses to this group, to this interest rate, if you switch the interest rate down a little bit, but you raise the annual fee a little bit. And if you raise the line this little bit, there are so many different marketing cells that the idea of trying to keep them all segregated, and to keep them all distinct as a plan from each other, is a burden that the large companies have told me would be enormous. And the idea of trying to track each of them for a certain period of time would be very difficult, because they already have, as

Oscar pointed out, the pre-screening requirements to be held, that to have all of these marketing things, it would ordinarily say all right. This one didn't work, out it goes. Let's pull the new one, but this is just what I'm told. I have no first-hand experience as to what the difficulty and the cost would be.

MR. NOWAK: Just so I understand, Russ, it would be a burden to just maintain --

MR. SCHRADER: To keep the --

MR. NOWAK: To retain the marketing memo?

MR. SCHRADER: To retain them, and to keep them separately and available for inspection, which is what I understand is the point of this.

MR. TORRES: But don't you look at response rates in terms of kind of the feedback that you get through the different marketing, and who's responding? I mean, I assume that the companies are tracking all that. I mean --

MR. SCHRADER: They do track it. Exactly. And what doesn't work, gets discarded, and then you move on to the next one.

MS. SCANLAN: You don't keep the --

MR. SCHRADER: You don't keep the records. You don't keep the ads that don't work. You don't keep the, you know, the draft copy that was discarded. You don't keep the, you know, everything associated with. Just the storage retention price of keeping the stuff, and having it filed, and having it readily available I'm told is very high.

MR. NOWAK: Janie.

MS. SCANLAN: Not only do you keep it in your -- you have to keep it in your own institution, but usually work with a large advertising agency, and that means there's two entities that have to keep this material because you work together. We don't do everything completely ourselves.

MR. NOWAK: Dolores, is that what the Fed meant by this? I'm -- that advertising agencies all over the country will have to retain marketing materials and the contracts with banks, credit card companies?

MS. SMITH: We had not -- we had really focused on the card issuer in the case of credit cards, not the advertising agencies.

MR. NOWAK: All right. It's good to know the Fed wasn't bringing advertising under its purview. Janie.

MS. BARRERA: I think there's a direct correlation though between the marketing plans and the financial literacy part, and the target market. And so, I think keeping this information is vital to see if there is any problems.

MR. NOWAK: Other questions or comments? I hope this gave you a good sense of our conversation yesterday. Thank you.

CHAIRPERSON BROADMAN: Thank you, Jeremy. In our last 15 minutes, we'll move on to Committee reports, and this is when each of the Chairs will talk to us about the work that they did in the Committees yesterday, and their plans, if they formulated them at this point, for future meetings, so I'd like to start with Russ, who will talk to us about deposit and delivery systems.

MR. SCHRADER: Okay. Thanks, Dorothy. We had three topics we discussed. One -- the first was Reg DD Truth in Savings Commentary. Second, electronic disclosures and e-sign. And third, a briefing on the U.S.A. Patriot Act.

With regard to the Reg DD Commentary Update, there were three parts that we discussed. First, free accounts and what services may or should be considered in evaluating a claim that an account are services free. The second, the effectiveness of the current disclosures under Reg DD with regard to fees and the usefulness. And the third, the use of technology and innovation, and how can we on-line migration of certain requirements and disclosures.

The second subject matter was electronic disclosures and e-sign generally, where there were three aspects of this that we've discussed. The first, the alerts. Should an alert come by e-mail? Should an alert come by the consumer's choice of e-mail or another device that must be offered by the financial institution? Must the financial institution offer any kind of choice?

The second part was the redelivery requirement, and there were a range of options we discussed from resending e-mail to the same address, to moving forward to sending physical mail to the consumer after scouring account files or institution files to find an alternate contact.

The final aspect of electronic disclosure and e-sign that we addressed was access to information, and how long should information be required to be maintained on the web site of a financial institution. Again, we discussed a range of options from the time that the consumer sees it, to 90 days, to the term of the account.

The third topic that we discussed was a briefing on the U.S.A. Patriot Act, and its interaction with other laws and regulations. Here, everyone was obviously completely supportive of the goals of the U.S.A. Patriot Act, and all the financial institutions want very much to cooperate, as much as they possibly can with the goals.

There was a discussion about the relationship between the U.S.A. Patriot Act, Bank Secrecy Act, Gramm-Leach-Bliley. We're also very concerned about the Right to Financial Privacy Act, and certain state laws, as well. And it may be important for the people at Treasury and here that are considering duties under the U.S.A. Patriot Act to make sure that they are pre-empted to any possible suits that could be brought, either directly or derivatively under state laws that are more protective of the consumer than GLB [Gramm-Leach-Bliley] is.

Finally, we discussed about the regulations that may be produced by Treasury after the April 24 deadline, and that they be mindful that it's taken them this long to get to that point, that the implementation be also commensurate with the additional burdens that will be imposed.

As far as what we will discuss next time, we will take up Reg E and stored value cards in the frame work, and revisit that.

CHAIRPERSON BROADMAN: Thank you, Russ. Jeremy, community affairs and housing. Is there anything that we didn't discuss here today that was discussed Wednesday?

MR. NOWAK: We're through. Yeah. We -- no, you've got it all. And next time we plan to focus in on a few issues, low income, how to -- what are some of the model programs to help bank the unbanked among low income Americans, some related Fair Lending issues, and then a conversation about the new markets tax credit actually we're going to take up.

CHAIRPERSON BROADMAN: Thank you.

Teresa, consumer credit.

MS. BRYCE: We discussed four topics yesterday. The first one was a discussion of the proposed revisions to the TILA [Truth in Lending Act] staff commentary with a particular focus on the issue of creditors with credit contracts not being required to give a copy of the contract to the consumer to take with them prior to entering into a transaction.

We talked about maybe the focus being more on making sure there's an opportunity to review the contract before signing it, rather than sort of the copy issue.

The second item was a discussion of what the Board might do with respect to the phraseology used for changes to the commentary that are clarifications, in order to minimize courts giving retroactive coverage, even though the change clearly has a mandatory compliance date subsequent to the clarification.

There was some difference of opinion, of course. There were some committee members who wanted retroactive application, but a number of us, of course, didn't want that.

The third topic was a continuation from last year of a discussion on alternative approaches to protect low or no rate loans from being refinanced in the early years unless it's in the borrower's interest, and that continues to be a thorny issue in trying to come up with a way to deal with that issue.

There was some consideration given on whether the original lender should flag these loans through either a deed restriction or mortgage documents labeled as such. And also, whether there was a need to cap the rate so that it definitely stayed within sort of the no and very low interest rate loan.

The last topic was a discussion of the content and format of account opening disclosures for credit cards, and there was some discussion about whether or not there really was an issue any more, given the changes that went into effect in October. And maybe there should be some time given to see how those are working before pursuing that issue further.

We've got a litany of about seven topics, which I'll run through really quickly that are -- we want to talk about at our next meeting. I don't know if we're going to get to them all. One is the possible use of the Shimmer Box for equity lines of credit. The second is addressing issues related to convenience checks attached to credit cards, particularly unauthorized use, unsolicited nature of those checks, and the extension of limited liability when used for purchases.

The third topic is to review the variable rate disclosures for home secured loans. Another topic, discussion of telephone cramming, which is the practice of using telephone company billing statements for consumer purchases, and whether that should be subject to Truth In Lending.

Our fifth issue is looking at issues related to the Fair Credit Reporting Act more generally. Six, discussing renter charter issues, particularly as it relates to payday loans. And the last topic, a continued discussion on changes to credit card periodic statements to make them more useful, and rules for clearing conspicuous disclosures in the electronic environment with respect to credit cards.

CHAIRPERSON BROADMAN: Thank you, Teresa. Good luck.

Manny, compliance and community reinvestment.

MR. CASANOVA: Thank you, Dorothy. Based on the discussion earlier, you know, we spent a lot of time focusing in on the comment summary, with a main focus being with the investment test. And I think we -- the Committee did an excellent job in bringing that out, and discussing the various issues affecting the investment test.

There are 13 topics that make up that comment summary, and we were able to touch on, including, of course, the investment test, on four other topics. For the next meeting, I think what we're really going to focus on, we're going to discuss the assessment area. There was a lot of discussion about that.

We're going to also review and discuss the definition of community development activities, as well as discuss the performance context aspect, with maybe touch on examiner training. And then we'll also discuss a service test, and try and see if we can fit in affiliate activities as well, so that's going to be our agenda for next meeting.

CHAIRPERSON BROADMAN: Okay. Thank you, Manny. We're at the end of our meeting, and I just want to say that if yesterday's discussions and today's discussions are any indication of how this year is going to go, we're in excellent shape.

I want to thank the Governors for your attendance and participation, and the Board's Staff, and the Council Members. We had very broad participation today, and I want to thank you for that.

Now we will adjourn. Lunch for the Council Members will be served in Dining Room L, which is just down the hall and to the left.

(Whereupon, the proceedings went off the record 12:58 p.m.)